

LAW MARKET FORCES UNDERLYING INTERNATIONAL JURISDICTIONAL
COMPETITION: THE CASE OF TAIWAN'S REGULATORY EVOLUTION ON OUTWARD
INVESTMENT IN MAINLAND CHINA, 1997-2008

BY

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DISSERTATION

Submitted in partial fulfillment of the requirements
for the degree of Doctor of the Science of Law in Law
in the Graduate College of the
University of Illinois at Urbana-Champaign, 2010

Urbana, Illinois

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ABSTRACT

This dissertation seeks to explore how basic law market demand and supply forces (or underlying exit and voice rights), interplaying under international jurisdictional competition among global legal centers, shape regulations laid down by such a democratically-constrained onshore jurisdiction as Taiwan. The thesis in this dissertation is that jurisdictional competition brought about by physical mobility would provoke a change in local laws. In general, the case study of Taiwan's regulatory evolution on outward investment in Mainland China ("China-Investment") from 1997 to 2008 further examines the extent to which jurisdictional competition fuelled by physical mobility may drive local legal changes. In particular, this case study is to test the process by which constraints on excessive regulation would be imposed by international jurisdictional competition stimulated by business demands and fuelled by physical mobility. To begin with, after incorporating basic theories involving the law market and so forth, I draw lessons from corporate charter competitions in the 19-century U.S. and contemporary Europe as well as the negative effect of the Sarbanes-Oxley Act of 2002 on foreign issuers, that jurisdictional competition constrains regulating jurisdictions from disregarding business demands and from imposing excessive regulation, and that jurisdictional competition brought about by mobility or exit would push for legal flexibility. Subsequently, this case study first displays a stage-by-stage liberalization of the regulation on China-Investment, generally from strictly mandatory to much more flexible legal regimes. This phenomenon could demonstrate the output of market interactions between demand and supply sides of the international law market among global legal centers. Specifically, this dissertation gives a causal interpretation that business demands of Taiwanese firms, via their exit and voice rights, galvanize the relaxation transitions of Taiwan's Capital Controls, while arriving at a positive conclusion that the usual demand and

supply forces operating in this international jurisdictional competition, which was stimulated by Taiwan-invested firms' business demands and fuelled by concomitant physical mobility, may have the effect of nudging the Taiwanese government in the direction of relaxing the regulation on China-Investment. Although Taiwan's government struggled to regulate China-Investment as effectively as possible, it failed after all due to the impacts of globalization in general and the denationalization of financial capital in particular. This, on the other hand, suggests that the fact that the international jurisdictional competition provoked by the heightened physical mobility under economic globalization turned the regulation all but ineffective has much to do with the stage-by-stage liberalization. Finally, even though proving a causal relationship is a challenge, this dissertation could, at the very least after ruling out major alternative theories, find a strong correlation between international jurisdictional competition and the stage-by-stage liberalization.

ACKNOWLEDGEMENTS

This project would not have been possible without the support of many people. I am most cordially thankful to Professor Larry E. Ribstein, who has been my advisor and mentor during my graduate work at the New York University and the University of Illinois. His persistent and patient supervision enabled me to recognize the profound depth of this subject while guiding me through the confusion to the completion of this dissertation. I am also grateful to my other committee members, Professors Amitai Aviram, Nuno Garoupa, and Andrew Pettit Morriss, who offered invaluable comments. Also thanks to Professors Wen-Yeu Wang, Wang-Ruu Tseng, and Jen-Guang Lin of National Taiwan University for continuous care and providing priceless guidance on my professional career. In addition, I appreciate the encouragement of In-Jaw Lai, the Honorable Chief Justice & President of the Judicial Yuan, Republic of China (Taiwan), who inspired me to pursue advanced legal study in the U.S as well as gave me good references. Finally and most importantly, wholehearted thanks to my respectable parents for their endless love and supporting my pursuit of this doctoral degree unconditionally.

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CHAPTER 1: INTRODUCTION

As stock markets in China (hereinafter also referred to as the “PRC,”¹ “Mainland China” or the “Mainland”) and Hong Kong performed well in recent years, Taiwan becomes attractive because it could be the last place to seek relatively cheap shares in companies which are extensively based in China. Until 2007, Taiwan’s “weighting in the widely used MSCI Emerging index was second only to South Korea’s.”² Nevertheless, preoccupied with national identity—including the extent of political independence from the PRC—and national security against threats from the Mainland, Taiwan’s government took measures to obstruct economic integration of the private sector with China, until Taiwan began turning to large-scale deregulation since President Ma of the Nationalists (“Kuomintang” or “KMT,” which is the current ruling party in Taiwan whereas the Democratic Progressive Party (“DPP”) was the former ruling party before the 2008 presidential election) won the presidential election in March 2008. Therefore, although many Taiwanese companies were believed to already earn hefty profits on their Mainland operations, they kept their successes a secret to avoid the Taiwanese government’s stringent restrictions on outward investment in Mainland China.

As a matter of fact, with Taiwan’s government attempting unsuccessfully to hinder further investment across the Taiwan Strait (the “Strait”), many Taiwanese corporations have weaved their ways through these bans so as to hand over needed funds to their affiliates or subsidiaries in Mainland China. Alternatively, in order to exit from

¹ The People’s Republic of China is commonly known as China.

² Keith Bradsher, *Investors Look to Taiwan in Hopes of Cashing In on China Boom*, N.Y. TIMES, Oct. 20, 2007, available at <http://www.nytimes.com/2007/10/20/business/worldbusiness/20exchange.html?fta=y>.

Taiwanese stock markets burdened with stringent regulation and to raise capital which the parent company in Taiwan could freely invest in Mainland China, many Taiwanese companies would also incorporate a company in a third area such as the Cayman Islands while owning a controlling interest of that company, or delegate investment in China to a company in the aforementioned third area. Then those offshore companies established or delegated would set up another company in Mainland China and in turn have that Chinese company locally listed on the Mainland; or more typically, those offshore companies would list shares in neighboring stock markets in the Greater Chinese Economy,³ especially the Hong Kong Stock Exchange (“HKSE”).

Inspired by corporate charter competitions in the 19-century U.S. and contemporary Europe as well as the negative impact of the Sarbanes-Oxley Act of 2002 (“SOX”) on the U.S. cross-listing market, this dissertation would first draw a positive lesson from the above stories that law market forces underlying jurisdictional competition would constrain jurisdictions from disregarding business demands and from imposing excessive regulation, and then apply this implication to prove my positive thesis that the output of these market interactions underlying international jurisdictional competition among global legal centers is that Taiwan’s excessive regulation on outward investment in

³ Kevin Zhang points out:

In the two decades since 1979, China, Taiwan, and Hong Kong have become one integrated economic region, driving the dramatic growth of investment, production, and trade in East Asia. Often referred to as “the Greater Chinese Economy,” this region represents in certain respects the triumph of economics over politics, in the sense that the three very different political entities have today become an economic trading, investing, and producing region, despite political and military conflict and long-standing, deep-seated suspicion and mistrust. FDI has been the engine driving these three entities into an increasingly intimate relationship.

Kevin H. Zhang, *China’s Inward FDI Boom and the Greater Chinese Economy*, in FINANCIAL MARKETS AND FOREIGN DIRECT INVESTMENT IN GREATER CHINA 165, 165 (Hung-gay Fung & Kevin H. Zhang eds., 2002) (citation omitted).

Mainland China is nudged in the direction of relaxation stage by stage from 1997 to 2008.

Specifically, Taiwanese firms' physical exit and threats of exit from Taiwan demonstrate the demand side of the law market in seeking legal flexibility, which first provokes the supply side in the international context. Further, where multiple suppliers such as Hong Kong and the Cayman Islands, by providing regulatory products of legal flexibility, participate in the international jurisdictional competition for these fleeing corporations' corporate charters, listings and other local economic transactions, the international supply force subsequently sparks the supply side in the domestic environment. That is, torrential economic exits in turn send signals to the political marketplace within Taiwan. Fugitive Taiwanese firms and those negatively affected by their exits voiced the petition for legal flexibility in the ensuing interest group competitions, which finally pressured Taiwan's government to meet business demands, or to loosen the excessive regulation.

As for the structure of this dissertation, in Chapter 2, Part A introduces general theories regarding jurisdictional competition and draws lessons from them to later test jurisdictional competition in Taiwan's phenomenon. First of all, the genesis of the jurisdictional competition theory can trace back to Charles Tiebout's 1956 article,⁴ which, as Esty and Geradin compress, suggests that "decentralized governance, with horizontally arrayed jurisdictions competing to attract residents on the basis of differing tax and benefits structures, would generate increased social welfare and produce a

⁴ Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956).

Pareto-superior outcome.”⁵ Subsequently, I come to the law market theory. Incorporating Albert Hirschman’s theory regarding options of exit and voice, interactions between forces driving the law market connote the demand side of law market generated by “exit,” the supply side in regulating jurisdictions where interest groups compete to “voice” their respective preferences, and regulatory responses from local political forces to the above exit signals.

Then when it comes to the international dimension, “with globalization—intensified trade and greater factor mobility—there is more immediate feedback to high-cost institutional systems and, with it, the need to adjust those systems to cost-effectiveness, not only passively but possibly even pro-actively.”⁶ Hence, regarding underlying factors spurring the law market in a global setting, the increase of international factor mobility brought about by globalization lowers firms’ exit costs and then intensifies the international jurisdictional competition for mobile resources. Out-flowing capital and emigrating labor would then compel regulatory jurisdictions to improve on the quality of their regulations. In other words, the international movement of production factors, delivered through domestic interest groups to political policy makers within a regulating jurisdiction, could galvanize the liberalization of excessive regulation.

Part B of Chapter 2 researches further into specific law markets in corporate charters and securities regulation. To begin with, from the nineteenth century jurisdictional competition of corporate law in the U.S., it is not difficult to infer not only that in a

⁵ Daniel C. Esty & Damien Geradin, *Introduction, in* REGULATORY COMPETITION AND ECONOMIC INTEGRATION: COMPARATIVE PERSPECTIVES at xxiii (Daniel C. Esty & Damien Geradin eds., 2001).

⁶ WOLFGANG KASPER & MANFRED E. STREIT, INSTITUTIONAL ECONOMICS: SOCIAL ORDER AND PUBLIC POLICY 403 (1998).

jurisdictional competition of repeated games, being a leader requires continuous respect for business demands, but also that if regulatory jurisdictions refuse to recognize business demands, firms have incentives to seek out more cost-effective or flexible laws in other jurisdictions, and this firm mobility would finally resign governments to lift overburdensome bans. Furthermore, the rise and fall of New Jersey in this competition for corporate charters illustrates the usual supply and demand forces at work in this corporate law market.

In turn, *Centros* and other descendent cases adjudicated by the European Court of Justice (“ECJ”) have provoked not only some European competition in the form of “tramp” UK incorporations⁷ by companies based elsewhere in Europe, but also responses by other European countries, particularly by revising their minimum capitalization requirements and simplifying incorporation requirements. In other words, in the wake of *Centros*, all Member States are required essentially to adhere to business demands especially with respect to corporate law for small firms. In a word, law market forces interplaying in both corporate law markets of the 19-century U.S. and contemporary Europe push regulatory transitions from mandatory to more flexible regimes. Although the breeding grounds of these two jurisdictional competitions seem in appearance to be disparate, underlying competitive dynamics is likely to be the same, in the sense that jurisdictional competition prompted by firms’ mobility could push relaxation of excessive regulation.

⁷ A pseudo-foreign corporation is also known as a migratory or “tramp” corporation. *Gries Sports Enterprises, Inc. v. Modell*, 473 N.E.2d 807, 809 (Ohio. 1943); *Toklan Royalty Corp. v. Tiffany*, 141 P.2d 571, 573 (Okla. 1943).

In Part B.2., theoretically, the advantages of state competition in the U.S. might be extended to the international scene, with international jurisdictional competition in securities regulation such as disclosure and anti-fraud rules. Notwithstanding the debate between proponents and opponents of issuer choice, foreign firms already can choose to “bond” their integrity by cross-listing in the United States or other improved markets, thereby subjecting themselves to these legal regimes added to those in their home countries. Much evidence supports this bonding explanation of cross-listing. Nonetheless, full-fledged international competition used to be much more hobbled by the fact that the United States at the earliest insisted on regulating all trading within its borders regardless of where the firms are based exactly after the enactment of SOX. In fact, SOX impacted non-U.S. firms so negatively that many foreign issuers were driven to list shares elsewhere. Foreign firms’ mobility fed the demand side of this law market, which subsequently spurred the supply side within the United States. Therefore, the U.S. responded to criticisms from German and other foreign companies by issuing rules that partially exempt foreign firms from some SOX requirements. The SOX case not only implies that constraints on over-stringent SOX to foreign issuers would be imposed by jurisdictional competition among global cross-listing markets fuelled by capital mobility, but also that international jurisdictional competition would provoke a change in over-burdensome regulation to a more flexible regime.

To conclude Chapter 2.B., international securities regulation seems quite different from the two corporate law markets mentioned above in that the former is at work on the national level rather than within federal systems of the United States or Europe, but the SOX case implies that law market forces similar to those working as to corporate law

within federal systems also work as to international securities regulation. As Ribstein and O’Hara stress, “[a]lthough federal securities laws arguably circumvent the [Internal Affairs Doctrine (the “IAD”)] by displacing state law, there is a market in international securities regulation that displays some of the same competitive processes as the market for state corporate law.”⁸ In other words, forces that operate in the law market generally apply in the international context as well.⁹

In Chapter 3, I apply lessons from Chapter 2 to the Taiwan case. In light of this Taiwanese phenomenon I try to illustrate international jurisdictional competition among global legal centers, principally indicating Hong Kong and other offshore financial centers (“OFC”) in British Central America. This competition might lead to the stage-by-stage lightening of capital limits on investment in the PRC laid down by Taiwan’s government.

In the first place, Chapter 3.A in a more micro level of analysis exemplifies this jurisdictional competition where HKSE acted as a dominant competitor against Taiwan in the market for Taiwanese firms’ listings in the Greater Chinese Economy. Part A.1. “The Demand Side of the Law Market” introduces the historical background and legal structures of the upper limits on outward investment in Mainland China (the “Capital Controls”) and related constraints on use of capital raised in Taiwanese stock markets towards investment in China (the “Constraints”) (the above two restrictions altogether hereinafter also referred to as the “Restrictions”). The Restrictions, on the one hand, ignore trends of economic globalization and concomitant business demands for

⁸ Larry E. Ribstein & Erin Ann O’Hara, *Corporations and the Market for Law*, 2008 U. ILL. L. REV. 661, 710 (2008).

⁹ *Id.* at 711-12.

increasing investments in Mainland China. On the other hand, the predicament of enforcing the Restrictions brings to light the core problem of the Restrictions—even if a jurisdiction acts with strong intentions to regulate economic transactions beyond its borders, it would be restrained from doing so as globalization weakens its regulatory capacity. In order to raise capital allowed to be used for investments in China, fugitive Taiwanese firms cannot but circumvent the Restrictions through common evasive tactics to list shares overseas.

This fact is further corroborated in Part A.2. “The Supply Side of the Law Market” that these Taiwanese firms spurn exchanges at home and choose to go public in other stock markets in the Greater Chinese Economy, not least Hong Kong, not primarily in order to opt into the laws thereof and to bond their insiders given the “bonding” effect, but rather mainly to “avoid” the Restrictions. In turn these Taiwanese firms’ physical exits and threats of exit motivate anti-regulatory and exit-affected interest groups in Taiwan to action. Subsequent to political competition with pro-regulatory interest groups, anti-regulatory interest groups combined with exit-affected ones successfully voiced their petition for legal flexibility especially through a critical political process in 2008—the presidential election in March. KMT’s presidential candidate, President Ma (advocating the pro-China and anti-regulatory policy), won the presidential election. Subsequently, the Restrictions have been largely relaxed in a timely manner.

In Part B of Chapter 3, we might find from a macro-narrative how the international jurisdictional competition among global legal centers plays a role in causing the relaxation of the Capital Controls: although the Capital Controls have turned much more

moderate by now, the Capital Controls' transitions can appropriately illustrate how law market forces underlying international jurisdictional competition would shape evolutionary changes of a democratically-constrained jurisdiction's regulations. I would argue that owing to globalization law market forces underlying international jurisdictional competition among global legal centers push Taiwan's government to relax its excessive regulation and create a more flexible regime. This positive thesis may be corroborated by my trend study as shown in Figure 2. To begin with, the amount of outward investment in Mainland China ("China-Investment") has been increasing significantly over time. The Capital Controls had been designed to stem the tide of China-Investment, so that Taiwan's government should have maintained or lowered the caps of China-Investment while enforcing the Capital Controls more and more stringently, which in my definition means that "Investment Allowance" should have been maintained or decreased over time. Nonetheless, after I study the regulatory transition of the Capital Controls—from the policy of *"jie ji yong ren"* (no haste, be patient) in 1997, to *"ji ji kai fang you xiao guan li"* (proactive liberalization with effective management) in 2001, to the policy of *"ji ji guan li you xiao kai fang"* (proactive management with effective liberalization) in 2006, and to the wide-scope relaxation of the Restrictions in 2008—the development is in the opposite direction: the Capital Controls are generally relaxed stage by stage and the range of relaxation in 2008 after President Ma of KMT took power is distinctly wider—the investment cap of a Taiwanese corporation maintaining its headquarters in Taiwan or of a multinational enterprise's Taiwanese subsidiary is wholly lifted.

Accordingly, I attempt to give a causal explanation to the paradox between the surge of China-Investment and the progressive increase of Investment Allowance. In short, we

can generalize a descriptive conclusion that jurisdictional competition played an important role in causing the lightening of the Capital Controls, or rather that business demands via exit and voice rights (or law market forces) nudge the Capital Controls in the direction of the stage-by-stage relaxation. To be concrete, the Capital Controls are so against business demands that China-based Taiwanese firms, by way of exit rights, seek out other regulatory jurisdictions to satisfy their demands for legal flexibility. For them, the law market of corporate charters, listings, and other economic activity among global legal centers emerges thanks to globalization which brings about higher firms' mobility and lower costs of exit, as well as to the WTO entry of both China and Taiwan which largely drives the removal of cross-Strait trade and investment barriers. These factors enhance their demands for a regulatory product without being subject to the Capital Controls, so as to facilitate their reducing manufacturing costs and grabbing more consumer markets in Mainland China. Since there are other jurisdictions, such as the Cayman Islands and Hong Kong, supplying alternative regulatory products of legal flexibility (the former mainly for corporate charters and the latter primarily for listing services), these Taiwanese firms would attempt regulatory arbitrage. Although Taiwan's administrative agencies, knowing the futility of acting unilaterally, intend to look for regulatory cooperation to enforce the Capital Controls, other offshore jurisdictions, given their own markets for these firms' local economic activity as well as the fact that Taiwan, unlike the U.S., has few bargaining chips for collaboration, have no incentive to help out the Taiwanese government.

Finally, since Taiwanese firms' continuous exits and accompanying outflows of capital and talent from local markets, these cross-border economic signals of physical exit

are sent to Taiwan's political marketplace. Therefore, Taiwan experienced radical changes of political power in 2001 and 2008 when anti-regulatory and exit-affected interest groups eventually dominate the interest group competition. Taiwanese firms' voice rights, strengthened by their exits in the first place, were successfully exercised to push for legal flexibility. Obviously, the feedback mechanisms, the demand and supply forces (or exit and voice rights), were translated into the regulatory evolution, or the stage-by-stage liberalization of the Capital Controls from 1997 to 2008. Furthermore, the regulatory transition of Taiwan's Capital Controls substantiates positive postulates that the international law market among global legal centers responds to the same general supply and demand forces as in corporate law markets and cross-listing markets discussed in Chapter 2.B., and that law market forces underlying international jurisdictional competition would push such a democratically-constrained onshore country as Taiwan to relax its excessive regulation towards a more cost-effective or 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, the stage-by-stage liberalization at issue could be attributed not just to the surge of Taiwanese outward investment in China under economic globalization, but to the fact that the international jurisdictional competition (chiefly spurred by the denationalization of financial capital) rendered the Capital Controls ineffective as explicated below in Chapter 3.B.2.1. Chapter 3.B.3 responds to major competing explanations. Chapter 4 is concluding remarks.

CHAPTER 2: JURISDICTIONAL COMPETITION IN GENERAL

A. Basic Theories

1. Voting with Feet and Jurisdictional Competition

The view of the law as a tradable good in a market comes from a broader theory originating in public economics with the publication of the Tiebout model in 1956, applicable to all public goods in general.¹⁰ In brief, this theory suggests that different state governments compete with each other in the supply of public goods to consumers who on their side can choose between the public goods offered according to their preferences.¹¹ Under this view, this market approach will most efficiently allocate public goods between the consumers according to their preferences, on the following conditions: (1) “people and resources are mobile” between jurisdictions; (2) “the number of jurisdictions is large;” (3) “jurisdictions are free to select any set of laws they desire;” and (4) “there are no spillovers,” positive or negative externalities, among jurisdictions.¹² Furthermore, Coffee adds another condition: “individuals or firms make the choice among jurisdictions . . . based simply on which jurisdiction . . . offers the most efficient

¹⁰ H. Spencer Banzhaf & Randall P. Walsh, *Do People Vote with Their Feet? An Empirical Test of Environmental Gentrification* 1 (RFF Discussion Paper No. 06-10, 2006), available at <http://ssrn.com/abstract=901657> (“Tiebout’s (1956) suggestion that people ‘vote with their feet’ to find the community that provides their optimal bundle of taxes and public goods has played a central role in the theory of local public finance over the past 50 years”). The basic structure underlying the Tiebout model is that “households do appear to vote with their feet in response to changes in public goods.” *Id.* at 4.

¹¹ Tiebout, *supra* note 4, at 424.

¹² Larry E. Ribstein & Bruce H. Kobayashi, *The Economics of Federalism* 3 (University of Illinois Law & Econ. Working Paper Series, Working Paper No. LE06-001, 2006), available at <http://ssrn.com/abstract=875626>.

and least costly regulatory regime.”¹³ To sum up, the more fully these conditions are fulfilled, the more likely jurisdictional competition would be effective.¹⁴

The above perspective is the regulatory competition or jurisdictional competition. As Geradin and McCahery note,

Regulatory competition is an economic theory of government organization that equates decentralization with efficient results. The theory makes an analogy between law and commodities, and then asserts that lower level governments—local, state, or national, as opposed to federal or supranational—should compete for citizens and factors of production when they regulate. It predicts that such competitively determined regulation will satisfy citizen preferences. The prediction has a normative implication for legal and political theory: just as price competition disciplines producers of private goods for the benefit of consumers, so regulatory competition promises to discipline government for the benefit of taxpaying citizens. Regulatory competition has been brought to bear on the entire range of federalism discussions, usually to support a devolutionary initiative or to oppose a proposal for federal intervention.¹⁵

There was theoretical arbitrage to legal contexts early in the field of law and economics. Lawyers, economists and political scientists in the U.S. have applied it to a wide range of subjects, from corporate law, to banking, to environment law, to intellectual property, and to trade law.¹⁶

¹³ John C. Coffee, Jr., *Competition versus Consolidation: The Significance of Organizational Structure in Financial and Securities Regulation*, 50 BUS. LAW. 447, 453-54 (1995).

¹⁴ For further discussion, see DENIS C. MUELLER, PUBLIC CHOICE III 186-206 (2003).

¹⁵ Damien Geradin & Joseph A. McCahery, *Regulatory Co-opetition: Transcending the Regulatory Competition Debate* 1 (Amsterdam Center for Law & Econ. Working Paper No. 2005-06, 2005), available at <http://ssrn.com/abstract=821087> (citation omitted).

¹⁶ See generally REGULATORY COMPETITION AND ECONOMIC INTEGRATION: COMPARATIVE PERSPECTIVES (Daniel C. Esty & Damien Geradin eds., 2001).

Easterbrook argues that competition among states for corporate charters is a good example of regulatory competition:

Although there has been a hubbub about the consequences of competition among the states for corporate charters, the data indicate that the competition has been beneficial to investors. Firms that announce plans to move their incorporation to Delaware realize significant gains. Because of the mobility of investment capital, it could hardly be otherwise. Delaware has no monopoly of investment opportunities, and if its corporate code did not offer features valuable to investors, they would place their money with firms incorporated elsewhere. Although it is hard to name other things as mobile as corporate charters and investment capital, it is also hard to find resources—save for land—that are immobile in the long run.¹⁷

To summarize advantages derived from jurisdictional competition, as Romano argues,

[t]he learning of the empirical research is altogether consistent with the understanding of the workings of regulatory competition, that competing regulators have superior incentives to a single regulator regarding the adoption of requirements of no efficacy, or whose efficacy is not worth their cost. Competing regulators have superior incentives because, when firms can choose their regulatory regime, they will not opt for a regime that imposes increased costs unless the accompanying benefits are worth the additional expense. Firms will exit [from] the regime that is not cost-justified for one that is, and regulators will learn from the pattern of inflows and outflows of firms which rules meet a cost-benefit test. Under the plausible assumption that regulators seek to maximize the number of regulated firms within their jurisdiction, regulators in a competitive environment will, accordingly, not only react more quickly to regulatory mistakes, but also select a different set of rules from monopoly regulators, from whose regulatory authority firms cannot exit.¹⁸

¹⁷ Frank H. Easterbrook, *Antitrust and the Economics of Federalism*, 26 J. L. & ECON., 23, 35 (1983) (footnote omitted).

¹⁸ Roberta Romano, *Is Regulatory Competition a Problem or Irrelevant for Corporate Governance?*, 21 OXFORD REV. ECON. POL'Y 212, 215-16 (2005) (citation omitted) (alteration in original).

More importantly, “while some view the normative aspect of [Tiebout’s] model (i.e., jurisdictional competition is efficient) as controversial, few would contest its positive aspect (i.e., competitive incentives drive local policies).”¹⁹ This dissertation is just focused on a purely descriptive perspective that demonstrates the causal effect between jurisdictional/regulatory competition and the relaxing of Taiwan’s Capital Controls.

2. Exit, Voice, and Interest Group Competition

Albert Hirschman argues that as members of a society such as a corporation or a country find that the quality of or the benefit provided by the human group is going down, they are fundamentally armed with two ways to respond: they might exit (break off the relation); or, they might voice (make an effort to mend or restore the relation by lodging their complaints or proposing some change).²⁰ As Mueller discusses,

Albert Hirschman develops the useful distinction between processes in which individuals express their preferences via entry or exit decisions, and those in which some form of written, verbal, or voice communication is employed. An example of the first would be a market for a private good in which buyers indicate their attitudes toward the price-quality characteristics of a good by increasing or decreasing (entry or exit) their purchases. An example of the exercise of voice to influence a price-cost nexus would be a complaint or commendation of the product delivered to the manufacturer.²¹

Under federalism, the private individuals and firms that “are subject to state regulation need not be content with a ‘voice’ right in the political process but can protect

¹⁹ Doron Teichman, *The Market for Criminal Justice: Federalism, Crime Control, and Jurisdictional Competition*, 103 MICH. L. REV. 1831, 1837 (2005) (alteration in original).

²⁰ See generally ALBERT O. HIRSCHMAN, EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES (1970).

²¹ MUELLER, *supra* note 14, at 182.

their interests through the right of ‘exit,’ that is, through the ability to avoid the difficulties of further association by picking up stock and going elsewhere.”²² Put simply, exit and voice rights can alternately and interactively check the monopoly power of local governments.²³ In particular, exit rights and mobility underlying jurisdictional competition produce various benefits; letting a voter supplement his “voice” with an option to “exit” from the jurisdiction could strongly restrict local governments’ powers to tax and regulate. Exit rights powerfully transmit market forces to influence political or regulatory structures.²⁴

In regard to interest group competition, “the legislature is itself a marketplace and interest groups compete with one another in that marketplace for legislature benefits.”²⁵

O’Hara further explains:

In this competitive process, as with all others, groups that are more successful at creating benefits for themselves at low cost are more likely to obtain the benefits that they seek. Laws therefore tend to benefit those groups that are able to (1) organize cheaply and effectively; (2) prevent others from entering the group to usurp a share of the benefits; and (3) minimize intra-group competition that threatens to dissipate the proceeds obtained.²⁶

Moreover, substantive regulations are often the product of three different types of interest groups: (1) groups that derive advantages from regulation (“pro-regulatory” interest groups); (2) groups that assume the direct cost of regulation (“anti-regulatory” interest

²² Richard A. Epstein, *Exit Rights under Federalism*, 55 LAW. & CONTEMP. PROBS. 147, 149 (1992).

²³ *Id.*

²⁴ Ribstein & Kobayashi, *supra* note 12, at 4.

²⁵ Erin A. O’Hara, *Opting Out of Regulation: A Public Choice Analysis of Contractual Choice of Law*, 53 VAND. L. REV. 1551, 1577 (2000). See generally Gary S. Becker, *A Theory of Competition among Pressure Groups for Political Influence*, 98 Q. J. ECON. 371 (1983) (arguing that competition for political favors facilitates checking deadweight costs connected with legislation).

²⁶ O’Hara, *supra* note 25, at 1577.

groups); and (3) “exit-affected” interest groups made up of those who are hurt if state regulations cause businesses or people to either leave the state or not come to the state in the first place.²⁷ Generally speaking, “competition among organized interest groups may (but will not always) constrain the enactment of bad laws.”²⁸

Last but not least, exit by some can add voice to others who benefit by the presence of those who have exited. Specifically, exit rights have a bearing on laws and institutions in the sense that they promote “exit-affected” interest groups, those powerful local interests that derive benefit from discouraging exit or bringing in new members. While “[t]he exit option motivates anti-regulatory interest groups that ‘stand in’ for the people and businesses that are directly hurt by a proposed law but are too weak by themselves to prevent its adoption,”²⁹ it is necessary that legislators and regulators weigh the demands of both anti-regulatory and exit-affected groups against those of pro-regulatory interest groups. In a word, “[m]obility therefore provides an indirect voice to outsiders and a stronger voice to insiders who will be burdened by a proposed law.”³⁰

3. The Law Market Dynamics

Building on Tiebout’s theory and Hirschman’s typology, O’Hara and Ribstein bring up the theory of the law market:

A market for law may have significant implications for political theory. Under the traditional view of politics, people who do not like their leaders elect new ones. In

²⁷ ERIN A. O’HARA & LARRY E. RIBSTEIN, *THE LAW MARKET* 133 (2009).

²⁸ *Id.* at 22.

²⁹ *Id.* at 28.

³⁰ *Id.* at 29.

other words, they exercise what Albert O. Hirschman has referred to as “voice.” However, coordinating the electorate is cumbersome and costly. Moreover, the political marketplace is often dominated by interest groups that can influence politicians with money and votes to act in ways that might not serve the public interest. Voting is not the only source of political power. People can choose the applicable law by deciding where to live—part of what Hirschman called “exit.” . . . Tiebout explicitly recognized a kind of consumer market in governments. There is no reason in principle this market would not embrace laws which, after all, are an important type of government-provided goods.³¹

As O’Hara and Ribstein further argue, the law market is referred to as 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.”³² The term “Market” here does not point to “particular sets of idealized conditions of exchange, but rather simply to buyers demanding a commodity (law) and sellers being willing to provide it for a benefit;” this type of exchange is contrasted with “the view that law is decreed by government and forced on parties subject to its jurisdiction.”³³ As for the demand or “buyer” side of the market, “parties ‘shopping’ for law have created their own market by using several mechanisms such as exit options for avoiding costly regulation.”³⁴ As for the supply or “seller” side of the market, shopping generates incentives for some interest groups to favor contracting or legal flexibility (anti-regulatory interest groups), and thus to oppose those that prefer regulation (pro-regulatory interest groups). The interest group competition “involves not only the groups directly affected by the regulation, but also

³¹ *Id.* at 13-14.

³² *Id.* at 65.

³³ *Id.* at 66.

³⁴ *Id.*

exit-affected interest groups, which have a stake in the parties' decisions whether to locate, invest, or litigate in the state.”³⁵ In a word, the basic law market demand and supply forces specify the operations of this market.³⁶

4. International Jurisdictional Competition

4.1 Globalization and Jurisdictional Competition

In general, “[t]he reduction in barriers to trade and the liberalization of financial markets, transportation and telecommunications have created the basis for the increase in flows of factors of production between jurisdictions.”³⁷ This increase in mobility is also because of the drop in exit costs:

Since the 1960s, the competition among distant locations and national jurisdictions for mobile production factors, such as capital, has greatly intensified. In part this is due to advances in technology. In the second half of the twentieth century, containerization, roll-on/roll-off ships, pipelines and jumbo jets have saved transport costs in innovative ways. But advances in transport technology pale in comparison to the revolutionary advances in communication (“the transportation of ideas”). The fax, satellite communication, fiber cables, computing and data compression, e-mail, microwave transmission and widely available portable video cameras have brought down the costs of long-distance communication by phenomenal margins. People are better informed about living and working conditions in distant places and civilizations.³⁸

³⁵ *Id.*

³⁶ *Id.* at 121.

³⁷ Geradin & McCahery, *supra* note 15, at 1.

³⁸ KASPER & STREIT, *supra* note 6, at 344.

The above phenomenon is “globalization,” which is essentially “the phenomenon of increased international factor mobility.”³⁹ Kasper further argues that “government administration is a production factor, since good government is an ingredient in production, raises the productivity of all the other production factors, and enhances a country’s attractiveness to mobile production factors.”⁴⁰ Furthermore, Geradin and McCahery also find:

As countries move to a more liberalized domestic economy, questions of competition between jurisdictions abound. With the prospect of increased capital mobility, it is becoming conventional wisdom that national governments are forced to perform their economic policy functions more efficiently since governments that yield optimal levels of public goods may be more successful in the competition between jurisdictions for attracting mobile resources. The concern to attract mobile resources has shaped entire areas of governmental policy and plays a determinative role for firms locating new plants.⁴¹

Since national laws and institutions are an important type of government-provided goods, globalization has also galvanized international jurisdictional competition for mobile production factors by offering better laws and institutions.

To exemplify how globalization promotes international jurisdictional competition, as David Law argues, globalization involves intensifying international jurisdictional competition for investment capital and human talent that might give rise to implications for the worldwide development of constitutional law. Global investment and migration

³⁹ WOLFGANG KASPER, GLOBAL COMPETITION, INSTITUTIONS, AND THE EAST-ASIAN ASCENDANCY 4 (1994).

⁴⁰ *Id.* at 11. In the second half of the 20th century, “[i]ncreasingly, local and national institutions are becoming a key cost factor that determines what is produced where—not surprisingly, because coordination costs account often for half of all costs and because these are greatly influenced by prevailing institutions.” KASPER & STREIT, *supra* note 38, at 345.

⁴¹ Geradin & McCahery, *supra* note 15, at 1.

patterns may impact the extent to which countries maintain certain constitutional rights. He adds: “[A]s capital and skilled labor become increasingly mobile, countries will face a growing incentive to compete for both by offering bundles of human and economic rights that are attractive to investors and elite workers.”⁴² He further argues that in “a ‘world market’ in human rights,”

countries bid for skilled workers by offering both pecuniary and non-pecuniary inducements that include greater or lesser degrees of personal freedom. . . . [C]ountries that do not boast the rights bundles available elsewhere must in effect pay skilled workers what might be called a “freedom premium” in order to compete successfully in the global market for human capital.⁴³

Put differently, “economic globalization includes competition among nations for investment and human capital. Nations compete by offering investors and those with high levels of human capital—the well-educated and trained—attractive packages of benefits. An important component of those packages . . . is constitutional protection.”⁴⁴ What’s more, “[p]eople with high levels of human capital are just about as mobile as investment capital, and will locate themselves in nations that provide them with what they want by way of freedom.”⁴⁵ Therefore, economic globalization forces national jurisdictions to offer better constitutional protection to engage in the international jurisdictional competition for investment capital and elite workers.

⁴² David S. Law, *Globalization and the Future of Constitutional Rights*, 102 NW. U.L. REV. 1277, 1282 (2008).

⁴³ *Id.* at 1283

⁴⁴ Mark V. Tushnet, *The Inevitable Globalization of Constitutional Law* 7 (Hague Institute for the Internationalization of Law; Harvard Pub. Law Working Paper No. 09-06, 2008), available at <http://ssrn.com/abstract=1317766>.

⁴⁵ *Id.* at 9.

Finally, globalization, or the worldwide intensified movement of capital, know-how and firms across national borders, strengthens the exit option for the subjects of national jurisdictions. This phenomenon “weakens the power of governments. . . . It is therefore useful to constrain the scope for opportunistic national interventions in international exchanges.”⁴⁶ For example, as Andrews argues, “the degree of international capital mobility systematically constrains state behavior by rewarding some actions and punishing others.”⁴⁷

4.2 Law Market Forces Underlying International Jurisdictional Competition

Following the insight of the law market as well as the dissection of globalization and jurisdictional competition, we can realize how law market forces are working in international jurisdictional competition. First of all, since globalization lowers exit costs across borders and enhances firm and capital mobility, globalization leads to international jurisdictional competition for worldwide mobile factors of production by offering better laws and institutions. We in turn come to the interactions between the economic process in the international environment and the political process within a jurisdiction when this jurisdiction engages in jurisdictional competition through changes in the provision of laws and institutions. Let’s suppose that the jurisdiction propose an excessive law favored by pro-regulatory interest groups, which create firms’ demand for legal flexibility and their incentive to leave. In the international economic process, firms, as “economic agents,” have some ability to manipulate jurisdictional choice. That is to say, this

⁴⁶ KASPER & STREIT, *supra* note 6, at 342. *See also id.* at 381.

⁴⁷ David M. Andrews, *Capital Mobility and State Autonomy: Toward a Structural Theory of International Monetary Relations*, 38 INT’L STUD. Q. 193, 193 (1994). *See also id.* at 194, 197.

mobility, in the first place, can feed the demand side of the law market which firms' exit rights underlie, and then spark competition for the supply of law by other jurisdictions on the international supply side. Exit and entry by firms seeking to avoid regulation creates costs and benefits for other interest groups in the jurisdiction. This mobility can thus activate the domestic interest group competition on the supply side. In particular, the exit or 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 to promote legal flexibility on the domestic supply side, even if the latter anti-regulatory groups could not alone defeat the regulation proposed by the pro-regulatory interest groups. This in turn pressures politicians or 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,"⁴⁸ and to enable the relaxation of the excessive law. Hence, where regulation might be excessive, the jurisdictional competition could push the regulating jurisdiction to improve the substantive content of local laws.⁴⁹ What's more, "[l]egal changes would be provoked by firms' increasing need for legal flexibility."⁵⁰ In other words, as Prof. 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."⁵¹ That is, the

⁴⁸ KASPER & STREIT, *supra* note 6, at 403.

⁴⁹ See O'HARA & RIBSTEIN, *supra* note 27, at 191, 199.

⁵⁰ *Id.* at 110.

⁵¹ Larry E. Ribstein, *Cross-Listing and Regulatory Competition*, REV. L. & ECON. Vol. 1, Issue 1, Art. 7, 97, 99 (2005), available at <http://www.bepress.com/rle/vol1/iss1/art7>.

feedback mechanisms, options of exit (choice of location) and voice (political action), might be translated into the regulatory evolution, or the liberalization of excessive regulation.

B. The Law Markets for Corporate Charters and Cross-Listings

1. Law Market Forces at Work in the U.S. and European Corporate Law Markets

Basically, the corporate law market is simply a part of the broader market for law.⁵² In general, a market for corporate law is based on parties' contracting for or choosing, through incorporation, the law of a specific state or nation. This market, as a self-ordering phenomenon, could impose discipline on lawmaking by forcing states or nations to compete with one another. Additionally, respecting contractual choice-of-law, or recognizing the incorporation of a locally-based foreign corporation, would encourage legal improvements to evolve more rapidly and efficaciously. With firms' ability to move among states or nations, the market for corporate law arises in both the U.S. and European federal systems despite local officials' efforts to protect their lawmaking authority.⁵³ This dissertation will hereby draw legal implications from the

⁵² Ribstein & O'Hara, *supra* note 8, at 665.

⁵³ See O'HARA & RIBSTEIN, *supra* note 27, at 217. O'Hara and Ribstein further argue:

Governments cannot control everyone everywhere. Physical mobility allows a person or firm to choose a single state whose law would apply to all her or its activities. States compete for mobile parties and their assets by attempting to provide the laws that they want. . . . [P]arties' fundamental ability to choose among these bundles generates a willingness on the part of states to enforce choice-of-law clauses, which in turn facilitates an even more valuable market in laws governing particular relationships and disputes.

Id. at 66.

nineteenth-century jurisdictional competition for corporate charters in the U.S. and the developing corporate charter competition in Europe.

1.1 Jurisdictional Competition in the U.S. at the Turn of the 20th Century

Ribstein and O’Hara argue: “The increasing mobility of the corporation in the latter part of the 19th century was an important factor in developing the IAD,”⁵⁴ or the “Incorporation Theory.”⁵⁵ This rule holds “that the law of the state of incorporation governs the relationship between the managers, the shareholders, and the corporation. Corporations can choose their place of incorporation without having any other connection with the state of incorporation.”⁵⁶ To be sure, “the corporate law market might be said to be a product of the industrial revolution.”⁵⁷ As O’Hara and Ribstein note,

when changes in business practices and technologies increased the benefits of prohibited practices and gave firms incentives to avoid regulatory impediments . . . firms had a choice either to engage in costly lobbying to remove local impediments or to move to states with laxer laws. Clearly they would welcome being able to choose a state’s law without physically moving there.⁵⁸

Historically, New Jersey thus became the first mover to attract foreign firms to incorporate locally. Grandy explains:

⁵⁴ Ribstein & O’Hara, *supra* note 8, at 675.

⁵⁵ Christian Kirchner, Richard W. Painter &, Wulf A. Kaal, *Regulatory Competition in EU Corporate Law after Inspire Art: Unbundling Delaware’s Product for Europe*, 2 EUR. COMPANY & FIN. L. REV. 159, 160 (2005).

⁵⁶ Ribstein & O’Hara, *supra* note 8, at 662 (footnote omitted). However, as discussed below in Chapter 2.B.1.2, until recently, Europe has long applied the so-called “real-seat” rule, under which the applicable law is that of the jurisdiction where the firm’s headquarters are located, but recent European case law has changed to adopt a type of the IAD. *Id.* at 706.

⁵⁷ *Id.* at 675.

⁵⁸ *Id.* at 676.

From 1888 through the general corporation law revision of 1896, New Jersey sought corporate charters by liberalizing its statutes. The constitutional amendments of 1875 set the stage for chartermongering by ending the era of special incorporation charters, requiring all corporations to charter under general laws. In 1888 two consecutive statutes allowed some corporations to merge and hold stock in other corporations. By 1893 the legislature had liberalized these laws so that most corporations could merge horizontally and hold stock in any foreign (non-New Jersey) or domestic corporation. General permission for New Jersey corporations to operate outside the state came in 1889, and by 1892 the state no longer required explicit permission—all corporations could presume such consent. New Jersey partially protected corporations operating outside its borders through reciprocal and retaliatory laws: the taxes and obligations imposed upon New Jersey firms operating in other states were imposed upon firms from those states operating in New Jersey.⁵⁹

In other words, this fact demonstrates that states also have incentives to protect the IAD because it enables their own corporate laws to be respected elsewhere. State courts also realize that their judgments which do not recognize the IAD could negatively impact their own state's corporations operating in other states.⁶⁰ Meanwhile, the states also, in a sense, lost their power to exclude foreign corporations (i.e. the power not to enforce the IAD) during the first decade of the 20th century, since “the Supreme Court overruled its earlier decisions and gave the corporation what amounted to a constitutional right to do lawful business in every state.”⁶¹

⁵⁹ Christopher Grandy, *New Jersey Corporate Chartermongering, 1875-1929*, 49 J. ECON. HIST. 677, 681 (1989) (footnote omitted).

⁶⁰ Ribstein & O'Hara, *supra* note 8, at 685.

⁶¹ HERBERT HOVENKAMP, *ENTERPRISE & AMERICAN LAW, 1836-1937*, at 249 (1991). In *Western Union Telegraph Co. v. Kansas*, the Supreme Court held: The exaction from a foreign telegraph company for the benefit of the permanent school fund of a “charter fee” of a given per cent of its entire authorized capital stock, as a condition of continuing to do local business in the state, is invalid under the commerce and due-process-of-law clauses of the Federal Constitution, as necessarily amounting to a burden and tax on the company's interstate business and on its property located or used outside the state. *See* 216 U.S. 1, 18 (1910).

At any rate, the corporate law market soon got its first test. Woodrow Wilson, the then Governor of New Jersey, responded in 1913 to reformers' protests against New Jersey's monopoly-friendly law by convincing the legislature to pass amendments to its corporate law in order to limit holding corporations and impose stringent antitrust regulation. Delaware swiftly substituted for New Jersey by allowing "tramp" firms to register without being subject to New Jersey's stricter laws. By the time New Jersey came to its senses and tried to recapture its business by reversing its regulation, it was too late—Delaware had entrenched itself as a leader in corporate law business and gave the corporations no reason to reverse their new choices while firms lost their trust in the New Jersey legislature.⁶²

From a contemporary perspective, the corporate law market, or the jurisdictional competition for corporate charters fuelled by firm mobility, did drive moderation of excessive regulation. The history of the changes made by New York, Michigan, Massachusetts and other leading industrial states is illustrative. The removal by these states of the limitations upon the size and powers of business corporations appears to have been due to the conviction that it was useless to maintain them in the sense that local restrictions would be evaded by firms incorporating in, say, New Jersey.⁶³ Indeed, as Yablon discusses,

the basic contours of the law that emerged in New Jersey in the 1890s is [sic] essentially the same as the Delaware law that governs most publicly traded corporations today. Many of the changes that New Jersey instituted at that

⁶² Ribstein & O'Hara, *supra* note 8, at 678-79. *See also* Grandy, *supra* note 59, at 689; Frederick Tung, *Before Competition: Origins of the Internal Affairs Doctrine*, 32 J. CORP. L. 33, 42-43 (2006); Frederick Tung, *Lost in Translation: From U.S. Corporate Charter Competition to Issuer Choice in International Securities Regulation*, 39 GA. L. REV. 525, 614 (2005).

⁶³ *Louis K. Liggett Co. v. Lee*, 288 U.S. 517, 560-64 (1933) (Brandeis, J., dissenting).

time—such as the abolition of limitations on the size, duration, and power of corporations to hold and sell stock in other corporations, limitations on potential shareholder liability to creditors for issuing undervalued shares, and development of enabling statutes giving incorporators greater freedom to create and structure corporate powers—were criticized at that time as removing important protections for the public. Most corporate law theorists today, however, would view them as reasonable, efficiency-promoting rules.⁶⁴

More importantly, the jurisdictional competition in the U.S. at the turn of the 20th century suggested that the actual content of a state’s corporate law might be less important than “its reputation and perceived commitment to the future content of its laws.”⁶⁵ In truth New Jersey failed afterwards for not sticking to its previous commitment to respecting business demands. As a matter of fact, as Yablon argues,

[a]fter 1900, New Jersey no longer had a competitive advantage over other chartering states, either with respect to price or the actual content of its laws, but was still able to compete quite effectively for new incorporations primarily on its reputation for reliability and responsiveness to the concerns of big business. . . . Many have argued that similar reputational factors, still tempered by a conservative approach to change, remain the driving force in Delaware’s dominance.⁶⁶

Therefore, it is not difficult to infer not only that in the jurisdictional competition of repeated games, being a leader requires continuous respect for business demands, but also that if regulatory jurisdictions refuse to meet business demands, firms have incentives to seek out more cost-justified laws in other jurisdictions. In turn this firm mobility would finally resign governments to lift excessive bans. Put differently, the rise and fall of New

⁶⁴ Charles M. Yablon, *The Historical Race Competition for Corporate Charters and the Rise and Decline of New Jersey: 1880-1910*, 32 J. CORP. L. 323, 328 (2007) (footnote omitted).

⁶⁵ *Id.* at 376.

⁶⁶ *Id.*

Jersey in this competition for corporate charters illustrates how the corporate law market works. As William Carney notes,

[c]ostly rent extractions in corporate laws by [pro-regulatory] interest groups, beyond those attainable through market transactions, raise costs for firms and lower returns for shareholders. Such gains for [pro-regulatory] interest groups can survive only if local firms subject to such laws are protected from firms operating under more efficient legal regimes. Competitive forces from outside a state legal system weaken the power of [pro-regulatory] interest groups to engage in rent-seeking activities and cause the resulting laws to be more public-regarding [and flexible].⁶⁷

From the perspective of the law market, at the turn of twentieth century,

legal changes were provoked by firms' increasing need for legal flexibility. For example, state rules requiring shares to be priced at their initial sale price, or "par," even as the market price rose or fell, significantly constrained corporate finance in modern capital markets. Firms could and probably did lobby their home states to ease these restrictions, but clearly found it easier to choose another states' law without having to physically move there.⁶⁸

If a state from which firms exit is unwilling to moderate the regulation or enforce the IAD to contain the outflow of firms and capital, just as the general law market forces "can pressure states to enforce contractual choice of law in order to encourage firms to maintain and enhance connections with their states,"⁶⁹ the same underlying supply and demand forces in the market for law contribute to deregulation or the enforcement of the IAD in non-competing states. For instance, if firms avoid non-enforcing states, such exit-affected interest groups as lawyers may lose potential clients and litigation business.

⁶⁷ William J. Carney, *The Political Economy of Competition for Corporate Charters*, 26 J. LEGAL STUD. 303, 303 (1997) (alteration in original).

⁶⁸ O'HARA & RIBSTEIN, *supra* note 27, at 110.

⁶⁹ *Id.* at 113.

Therefore, “ignoring the IAD as applied to local firms could deter firms from making significant local investments, which might trigger a local political backlash against the regulation.”⁷⁰ In sum, the output of these market interactions in the jurisdictional competition for corporate charters demonstrates that the U.S. corporate law market operates to satisfy business demands for legal flexibility.

1.2 Jurisdictional Competition in Europe at the Turn of the 21st Century

Not long ago, European countries had applied the so-called “real-seat” (*siège réel*, *siège social*) choice-of-law rule, under which the law of a “company’s real or effective seat,” its “central administration,” or its “brain or nerve center” where the main operational decisions are made, rather than that of statutory domicile (registered office), was followed by European nations except for the United Kingdom and the Netherlands.⁷¹ Nevertheless, as in the U.S., increased firm mobility provoked by liberal trade rules within the European Union (“EU”) put pressure on the choice of law rule. The revolution took place in 1999 with the *Centros* case, which were followed by two others—the *Überseering* and *Inspire Art* cases. Generally speaking, these cases clarified that the EU law fundamentally protects full-fledged Delaware-type corporate charter competition for “tramp” or, in European parlance “brass plate,” corporations.⁷²

⁷⁰ *Id.*

⁷¹ See ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* 132 (1993); also ERIC STEIN, *HARMONIZATION OF EUROPEAN COMPANY LAWS, NATIONAL REFORM AND TRANSNATIONAL COORDINATION* 29-31 (1971).

⁷² Ribstein & O’Hara, *supra* note 8, at 707.

What should be emphasized first here is the seminal *Cenros* case.⁷³ On March 9, 1999, the ECJ held that Centros Ltd., incorporated in the UK, could not be denied registration in the Danish Business Register even though the company operated entirely within Denmark and was incorporated in the UK merely in order to avoid more stringent Danish incorporation requirements on minimum capital.⁷⁴ In other words, the founders of a pseudo-foreign corporation⁷⁵ publicly acknowledged that they intended to circumvent the Danish minimum capital rules, and the ECJ disallowed the Danish regulators from interfering.⁷⁶ This case suggested that even though a company, as a pseudo-foreign corporation, simply wanted the more favorable and flexible law of the incorporation jurisdiction, the ECJ would also enforce the Incorporation Theory or the IAD, because the real seat doctrine violated the “freedom of establishment” given by Article 43(1) of the Treaty Establishing the European Community (the “EC Treaty”).⁷⁷ As Enriques and Gelter note, “[c]orrespondingly, the ruling prevented Member States from imposing their own corporate law on such businesses, other than under very limited conditions. In the past few years, newly incorporated businesses have started to take advantage of this new development, choosing English law in relatively high numbers.”⁷⁸

⁷³ Case C-212/97, *Centros Ltd. v. Erhvervs-og Selskabsstyrelsen*, [1999] E.C.R. I-1459.

⁷⁴ Marco Becht, Colin Mayer & Hannes F. Wagner, *Where Do Firms Incorporate? Deregulation and the Cost of Entry*, 14 J. CORP. FIN. 241, 246 (2008).

⁷⁵ Pseudo-foreign corporations are “corporations essentially local in character but incorporated in a foreign state.” Elvin R. Latty, *Pseudo-Foreign Corporations*, 65 YALE L. J. 137, 137 (1955). *See also id.* at 161-62. In another word, this corporation “is incorporated in another jurisdiction but has no significant contacts with that other jurisdiction.” Christian Kersting, *Corporate Choice of Law — A Comparison of the United States and European Systems and A Proposal for A European Directive* 28 BROOK. J. INT’LL. 1, 1 (2002).

⁷⁶ *Id.* at 74.

⁷⁷ *See* Jens C. Dammann, Note, *The Future of Codetermination after Centros: Will German Corporate Law Move Closer to the U.S. Model?*, 8 FORDHAM J. CORP. & FIN. L. 607, 614-18 (2003).

⁷⁸ Luca Enriques & Martin Gelter, *How the Old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law*, 81 TUL. L. REV. 577, 580 (2007) (footnote omitted).

In addition, the *Inspire Art* case⁷⁹ should be stressed as well. On September 30, 2003, the ECJ further confirmed the decision by Inspire Art Ltd.—a private company incorporated in Folkestone, England—to incorporate there; meanwhile it had its main business extensively within the Netherlands. The Dutch Government maintained that while the company were able to legally operate in the Netherlands, it was necessary for it to abide by existing laws provided for real foreign corporations, which *inter alia* requires “that directors are personally liable if the firm has minimum capital below the minimum capital requirement for Dutch firms.”⁸⁰ The ECJ held that Inspire Art Ltd.’s tactic was “permissible even if the only reason for incorporating in the UK was to circumvent Dutch minimum capital requirements.”⁸¹ That is, the ECJ stated that the Netherlands could not impose local regulations on a locally-based company that had incorporated elsewhere solely in order to circumvent these regulations.

The above cases determined a European version of the IAD or the Incorporation Theory, “by which firms that incorporate in one Member State of the E.U. are free to do business in any other Member State,” and stressed “that freedom of incorporation also holds for ‘round-trip’ incorporations, when residents of country A incorporate in country B with the sole purpose of doing business in country A.”⁸² Evidently, *Centros* and other following cases have galvanized not only certain European competition in the form of “tramp” UK incorporations by firms based somewhere else in Europe, but also regulatory

⁷⁹ Case C-167/01, *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd.*, [2003] E.C.R. I-10155.

⁸⁰ Becht et al., *supra* note 74, at 246.

⁸¹ *Id.* at 243.

⁸² *Id.*

responses by other European countries to modify their minimum capital rules and cutting down costs of incorporations.⁸³

To be concrete, as Enriques & Gelter discuss, the E.U. Second Directive

requires public corporations to have a legal capital of at least €25,000, which need not be entirely covered by assets at the time of incorporation. With the Second Directive not applying to private limited companies (Ltds), Member States have been able to choose freely the amount for this set of corporations. This resulted in a broad variety of regulations, ranging from no such requirement in the [UK], Ireland, and Cyprus to a requirement of €35,000 in Austria. *Centros* has already induced France, effectively to abolish minimum capital for private corporations, and even the German Ministry of Justice proposed a reduction from €25,000 to €10,000.⁸⁴

Accordingly, since the adjudication of *Centros*, some regulatory arbitrage at the incorporation country in order to escape rules on minimum capital for private corporations have already led to “defensive regulatory competition,” by which a few Member States such as France and Germany have already begun to relax these requirements “that were apparently the outcome of isolation from competition.”⁸⁵ To put it another way, the regulatory arbitrage “can, at least partly, be credited for a trend toward the abolition of minimum capital requirements in some countries.”⁸⁶ Also, since these avoided minimum capital requirements are outdated as well as unhelpful to creditors and thus rational creditors should not be concerned about them, “then the changes in the law induced by corporate law arbitrage so far are not really an issue of creditor protection, but rather a removal of administrative slack affecting only the interests of the founders of

⁸³ Ribstein & O’Hara, *supra* note 8, at 707.

⁸⁴ Enriques & Gelter, *supra* note 78, at 600-01 (alteration in original) (footnote omitted).

⁸⁵ *Id.* at 600.

⁸⁶ *Id.* at 613.

new companies.”⁸⁷ More importantly, European countries are responding to the inflow of new incorporations to the UK by lowering or abolishing minimum capital requirements and costs of incorporation more generally. Further, “[t]his race to match [UK] standards shares characteristics with the regulatory competition emphasized by the U.S. corporate mobility,” even though the phenomena in the E.U. are different from those within the U.S.⁸⁸

What’s more, before the corporate charter competition in Europe was initiated, the legal system creating the U.S. common market where there is no tariffs made it possible for U.S. firms to exit from costly legal regimes from state to state, which explains the competitive difference between Europe and the U.S. Exactly as Carney argues, “[t]hese different competitive settings explain substantive differences in corporate laws.”⁸⁹ In the U.S., since there are regulators competing with each other for corporate charters, “mandatory provisions that are not cost-justified will tend not to survive over time because firms will exit [from] the regime with the undesirable mandates, migrating to regimes in which they are absent.”⁹⁰ As discussed above, the “real-seat” rule might have obstructed jurisdictional competition in the E.U. Studying the difference between U.S. states’ corporation laws and those of E.U. Member States, William Carney found that there are a large percentage of the mandates in the EU company law directives; most of them don’t exist in any U.S. state’s laws. In effect, these mandates which used to be in U.S. state codes have been abolished for several decades since they are not favorable for

⁸⁷ *Id.*

⁸⁸ Becht et al., *supra* note 74, at 252 (alteration in original).

⁸⁹ Carney, *supra* note 67, at 303.

⁹⁰ Romano, *supra* note 18, at 217.

contemporary business practices.⁹¹ This evidence might support the suggestion that the ongoing jurisdictional competition for corporate charters in Europe is, after *Centros*, nudging European corporate law, at least for private limited companies, in the direction of legal flexibility. This trend of fewer excessive mandates in the corporate law market, or rather the trend toward the abolition of minimum capital requirements, can also be explained by applying the same general supply and demand law market forces as in the U.S. to European firms' business demands for legal flexibility.⁹² Furthermore, subsequent to *Centros*, all Member States in the EU are required essentially to adhere to business demands for regulatory products of legal flexibility, which are driving the European corporate law market.

To put it in more detail, even though Europe and the U.S. have distinct competitive environments, the same essential forces of the law market reign in both situations.⁹³ Legislators in both systems seek to regulate corporate governance under the support of local pro-regulatory interest groups just as they deal with other types of contracts. However, the ECJ rulings led by *Centros* have created an active incorporation market in the European Union. As Becht et al. note, “[i]n some countries in particular, entrepreneurs are increasingly aware that they can freely choose among all the limited liability vehicles in the EU to run a business in their home state.”⁹⁴ Small firms' mobility, first enhanced by *Centros* and other following cases, feeds the demand side of the law market which their exit rights underlie, and then sparks competition for the supply of law

⁹¹ Carney, *supra* note 67, at 319-24.

⁹² See O'HARA & RIBSTEIN, *supra* note 27, at 117.

⁹³ Ribstein & O'Hara, *supra* note 8, at 709.

⁹⁴ Marco Becht, Luca Enriques & Veronika Korom, *Centros and the Cost of Branching*, 9 J. CORP. L. STUD. 171, 172 (2009).

by foreign jurisdictions. Those firms thus attempt regulatory arbitrage in other E.U. Member States to satisfy their demands for legal flexibility. For example, “[b]etween 2003 and 2006 more than 40,000 residents of Germany incorporated a UK Limited.”⁹⁵ Apparently, on the international supply side, the UK has catered to this market, at least to the extent of lowering incorporation costs for small firms. Moreover, small firms’ exit strengthens their voice on the domestic supply side to petition for less costly regulation of incorporation. We can find evidence that the governments of France, Germany and the Netherlands carried through reform with a view either to facilitating establishment of small firms and entrepreneurship in their own countries or to preventing their losing jurisdictional control of considerable portions of their economies.⁹⁶ Specifically, Becht et al. note that “there is a political cost of loss of control in the case of entrepreneurs choosing to incorporate abroad. If corporate law is a means of implementing a political agenda then politicians have an incentive to keep entrepreneurs from incorporating their companies abroad.”⁹⁷ Put differently, the demand force, or the economic exit in the international environment signaled by small firms, bolsters their voice rights in the political process in the domestic context, and this domestic supply force then pressures politicians or lawmakers within respective Member States to enable the relaxation of outdated minimum capital requirements. In a word, spurred by the ECJ rulings, law market forces underlying jurisdictional competition among Member States are leading to local governments’ providing less costly corporate law, or rather the trend towards the lightening of rules on minimum capital at least for small firms.

⁹⁵ *Id.*

⁹⁶ Becht et al., *supra* note 74, at 252 (“Domestic incorporation is *per se* perceived to be important even if it does not bear directly on government revenues or the location of production or control”).

⁹⁷ *Id.* at 243.

1.3 Summary

What drives the corporate charter competitions in the 19-century U.S. and contemporary Europe? Why do they end up with a trend towards legal flexibility, or liberalization of excessive regulation? To start with the implication from the U.S. story, for New Jersey to succeed, other states had to apply New Jersey law to New Jersey corporations. Why did they cooperate? The explanation ultimately rests at least partly on demand-side factors. Without broader recognition of New Jersey law, corporations might have decided to sell their stock and locate their factories and other corporate assets only in states that applied the IAD. To be sure, these moves could impose significant costs on firms, particularly if firms had to forgo conducting business with customers, suppliers or shareholders in non-cooperating states. But at the same time corporations benefited significantly from the flexible rules New Jersey offered. And they also had strong reasons to want a single corporate law to apply to their internal affairs.⁹⁸ As Ribstein and O’Hara argue,

the corporate law market is simply a part of the broader market for law. . . . [T]he law market exists because parties to most contractual relationships have a strong incentive to contract for the law applicable to those relationships. States enforce these contracts despite the fact that they have the effect of eroding connected states’ regulatory power. States cede this regulatory authority in order to attract, or at least to avoid repelling, mobile firms. In short, the IAD did not spring only from forces unique to corporations, but also from these general law market forces.⁹⁹

Once more, the usual supply and demand forces of the law market are functioning in the European jurisdictional competition for corporate charters, even if “this time under

⁹⁸ Ribstein & O’Hara, *supra* note 8, at 677-78.

⁹⁹ O’HARA & RIBSTEIN, *supra* note 27, at 109.

different legal and cultural conditions from those in the United States.”¹⁰⁰

It appears that the jurisdictional competition in Europe occurred later than that of the U.S., following the rash of American business mergers beginning in the 1880s by nearly a century. Even though there are different competitive conditions between Europe and the U.S., “[a]ny differences between the United States and the EU will not be because different forces are at work, but because the specific environment affects the strength of each of these forces—the demand for regulation . . . the supply of regulation . . . and the resistance of local pro-regulatory interest groups”¹⁰¹ To put it somewhat differently, even if the breeding grounds of these two phenomena seem in appearance to be disparate, the underlying competitive dynamics may, to an extent, be the same, in the sense that, responding to similar law market supply and demand forces, jurisdictional competition in both federal systems spurred by business demands for legal flexibility drove the provision of increasingly cost-effective corporate law. That is not merely because jurisdictional competition “provides regulators with incentives and the necessary information to be accountable and responsive to the demands of the regulated,” but also “because there is a feedback mechanism in a competitive system that indicates to decisionmakers when a regime need to be adapted and penalized them when they fail to respond: the flows of firms out of regimes that are antiquated and into regimes that are not.”¹⁰² To sum up, as Romano argues, “[t]his is an important regulatory characteristic in the corporate context,

¹⁰⁰ *Id.* at 123.

¹⁰¹ Ribstein & O’Hara, *supra* note 8, at 710.

¹⁰² Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 *YALE L. J.* 1521, 1598 (2005).

because firms operate in a changing business environment, and their regulatory needs concomitantly change over time.”¹⁰³

2. Law Market Forces Underlying Jurisdictional Competition in International Securities Regulation: The Case of the Sarbanes-Oxley Act of 2002

There are strong arguments favoring extending jurisdictional competition from the American competition between states for corporate charters into international competition between securities regulators. This normative concept of issuer choice has been in a fierce debate among scholars. Some commentators propose permitting issuers to choose their disclosure regime. Specifically, proponents of issuer choice argue that when foreign firms enter U.S. capital markets, they should be permitted to obey the securities laws of the jurisdiction that they choose rather than the regulations provided by the Securities and Exchanges Commission (“SEC”). The proposal of issuer choice, by taking regulatory monopolies away from regulatory agencies such as the SEC, would force the agencies to make improvement on the quality of their respective local regulations.¹⁰⁴ In the meantime, opponents of issuer choice argue that it’s inevitable that jurisdictional competition in securities regulation would result in a race to the bottom where issuers would find jurisdictions with the least strict legal rules and the lowest degree of investor protection, which might drive the overall quality of securities regulation to decline.¹⁰⁵

¹⁰³ *Id.* at 1598-99.

¹⁰⁴ See, e.g., Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903 (1998); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L. J. 2359 (1998); Roberta Romano, *The Need for Competition in International Securities Regulation*, 2 THEORETICAL INQ. L. 387 (2001).

¹⁰⁵ See, e.g., Merritt B. Fox, *The Securities Globalization Disclosure Debate*, 78 WASH. U. L. Q. 567 (2000); Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment*, 85 VA. L. REV. 1335 (1999); Merritt B. Fox, *The Issuer Choice Debate*, 2 THEORETICAL INQ. L. 563 (2001).

Nonetheless, “[p]artial competition exists already, through firms’ choices of where to list and issue their shares.”¹⁰⁶ Furthermore, “[d]espite some commentators’ fears of a race-to-the-bottom in securities regulation, there is substantial evidence that issuers have chosen to bond their integrity by deliberately choosing regimes with more rigorous regulation.”¹⁰⁷ In another word, foreign firms actually can choose to “bond” their insiders by cross-listing in the United States or other improved jurisdictions, thereby rendering themselves subject to these stricter legal rules in addition to the regulations in their home countries. Considerable evidence lends support to this bonding explanation of cross-listing.¹⁰⁸ Nevertheless, with SOX, “full-fledged international competition is currently hobbled by the fact that the United States insists on regulating all trading within its borders regardless of where the firms are based.”¹⁰⁹ In contrast to the normative debate on issuer choice, this dissertation seeks to elaborate on a positive statement that law market forces underlying international jurisdictional competition have provoked partial exemptions and relaxation of mandatory rules in SOX as the U.S. aims at encouraging foreign issuers to raise capital there.

To begin with, “the past two decades have witnessed the large-scale process of internationalization. . . . The U.S. loosened disclosure regulation for foreign issuers throughout the period of internationalization to maintain a competitive advantage in attracting participants from the emerging markets.”¹¹⁰ After corporate catastrophes like

¹⁰⁶ Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLAL. REV. 781, 843 (2001).

¹⁰⁷ Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 J. CORP. L. 1, 60 (2002) (footnote omitted).

¹⁰⁸ Ribstein, *supra* note 51, at 104, 112.

¹⁰⁹ HENRY N. BUTLER & LARRY E. RIBSTEIN, *THE SARBANES-OXLEY DEBACLE: WHAT WE’VE LEARNED; HOW TO FIX IT* 35 (2006).

¹¹⁰ Erin Marks, *The Sarbanes-Oxley Act: Costs and Trade offs Relating to International Application and*

Enron's, Congress wrote SOX to strengthen the scope of federal regulation from disclosure to corporate internal governance while SOX was applied to domestic issuers and non-U.S. issuers, otherwise known as foreign private issuers ("FPI"s), equally. Prof. Ribstein, however, notes:

[R]egulation may be perverse because markets do not always react to regulation the way regulators predict they will. For example, rather than pursuing the same activities more carefully, regulated parties may simply switch to safer activities that are less likely to lead to the sort of bad outcomes that attract regulatory scrutiny. A specific example of how markets can react to regulation concerns the risk that a party will simply move out of reach. Though federal regulation like SOX is harder for firms to avoid than state law, even the federal securities laws have limited reach. While it is unlikely that U.S.-based firms will move their activities offshore, stricter U.S. law might keep non-U.S.-based firms out of U.S. markets.¹¹¹

Consequently, in order to attract back or retain non-U.S. issuers in the U.S. stock markets, the U.S. government release exemptions for FPIs from excessive regulation in SOX. SOX's effect on the cross-listing market not only suggests that the higher costs of regulation within jurisdictions are imposed on firms, the more likely firms exit and flee to where regulation is more flexible, but also illustrates the competitive constraints on federal law.

2.1 The U.S. Legal Regime Facing Foreign Private Issuers

Most of the foreign issuers which have their shares traded in the U.S. would issue American Depository Receipts ("ADR"s). This method makes American investors not

Convergence, 17 RES. ACCT. REG. 233, 254 (2004).

¹¹¹ Larry E. Ribstein, *Sarbox: The Road to Nirvana*, 2004 MICH. ST. L. REV. 279, 292 (2004).

just able to make investment in non-U.S. securities without worrying that cross-border transactions could often be complicated and costly, but also to gain benefits from largely the same financial and corporate governance rights as domestic shareholders of the non-U.S. issuers may enjoy. As the JP Morgan ADR Reference Guide depicts, an ADR is issued by a U.S. bank serving as an agent to transfer and issue ADRs. Each ADR is represented by a particular number of a foreign firm's domestic shares. There are four different kinds of ADR programs for foreign issuers to choose: Level I (over the counter, "OTC"), Level II (listed on exchanges), Level III (public offering), and Level IV (Rule 144A private placement). Normally, only Level II and Level III programs must obey the registration and reporting requirements of the Securities Exchange Act of 1934 (the "Exchange Act").¹¹²

Traditionally, the SEC has been promulgating a regulatory scheme differentiating firms which issue shares in the U.S. market. Domestic issuers need to comply with a full-fledged regulatory model whereas FPIs need only to obey a less demanding alternative, or a lower degree of disclosure for raising public capital under the Securities Act of 1933. FPIs are also substantially exempted from the Exchange Act's reporting provision.¹¹³ As Marks finds,

[s]ince its inception in the 1930s and particularly throughout the period of internationalization in the 1990s, the SEC has expressed its desire to attract foreign issuers to U.S. capital markets through accommodating and reducing disclosure requirements for foreign private issuers. These regulatory decisions easing

¹¹² Peter Hostak, Thomas Lys & Yong (George) Yang, *Is the Sarbanes-Oxley Act Scaring Away Lemons or Oranges? An Examination of the Impact of the Sarbanes-Oxley Act on the Attractiveness of U.S. Capital Markets to Foreign Firms*, 10-11 (Sep. 1, 2006), http://www.baf.cuhk.edu.hk/research/cig/pdf_download/SOX.pdf.

¹¹³ Steve M. Davidoff, *Regulating Listings in a Global Market*, 86 N. C. L. REV. 89, 130 (2007).

disclosure requirements have bolstered the demands of foreign firms in raising capital in the U.S. stock markets. Thus, the U.S. markets in the 1990s witnessed an explosion of foreign firms registering with the SEC, enabling their ability to raise capital in the U.S. markets.¹¹⁴

The corporate catastrophes of Enron and other American conglomerates contributed to a re-consideration of what are the better regulatory regimes to prevent fraud. These frauds took place due to “monitoring failures at several levels, including directors, prominent accounting and law firms, institutional shareholders, debt rating agencies, and securities analysts, and apparently escaped detection by supposedly efficient securities markets. In response to arguments that government regulators needed to restore confidence in the securities markets, Congress passed the [SOX].”¹¹⁵ As Prof. Ribstein notes, SOX “reflects a potential shift in the philosophy underlying the US securities laws from disclosure to substantive regulation of corporate governance” while “[t]his shift significantly affects foreign firms’ costs of complying with US law.”¹¹⁶ In addition, breaking from past securities law tradition, Congress wrote SOX to apply to domestic issuers and FPIs alike. In spite of opposition and possible retaliation, the SEC is determined to apply this law equally. Why was there such a significant shift in regulatory philosophy? To answer this question, Marks argues:

One possible explanation for this shift in policy lies with congressional sentiment against U.S. companies that incorporate offshore for tax advantages [as pseudo-foreign corporations]. The practice, often referred to as “corporate inversion,” became a hot political issue after the September 11 terrorist attacks. Tyco left the U.S. to incorporate in Bermuda in 1997 to lower its effective tax rate.

¹¹⁴ Marks, *supra* note 110 at 238.

¹¹⁵ Larry E. Ribstein, *International Implications of Sarbanes-Oxley: Raising the Rent of US Law*, 3 J. CORP. L. STUD. 299, 299 (2003) (footnote omitted) (alteration in original).

¹¹⁶ *Id.* at 300.

In May 2002, Stanley Works announced plans to reincorporate in Bermuda to save up to \$30 million per year paid in taxes on foreign-earned income. Under intense political pressure, however, Stanley Works abandoned plans to reincorporate in Bermuda in August 2002, and Tyco began to consider a move back to the U.S. to end doubts about its transparency and corporate governance in October 2002. By applying SOX extraterritorially, Congress sent a message to U.S. companies considering a move offshore: foreign firms would no longer enjoy protection under the U.S. securities laws.¹¹⁷

Since SOX was intended to cover all SEC reporting companies, there was no exception for FPIs, other than those issuing Level I and Level IV ADRs, which need not comply with SEC reporting requirements. SOX did not offer flexibility for the SEC to explain legislative intent and to provide foreign issuers with exemptions save rules related to the audit committee, which were later loosened from the initial regulation.¹¹⁸ For instance, the SEC on August 2, 2002 released its proposed rules—Certification of Disclosure in Companies’ Quarterly and Annual Reports—which were required under Section 302 of SOX. In line with the absence of flexibility, “the new rules provided no exemptions for foreign issuers and specifically emphasized that the ‘no exemption’ policy is required under [SOX]. However, the SEC has retained some flexibility in the timetable to implement the various provisions of [SOX].”¹¹⁹ Therefore, as Davidoff points out, “the increased level of regulation imposed on non-U.S. issuers by the Sarbanes-Oxley

¹¹⁷ Marks, *supra* note 110 at 239 (alteration in original) (citation omitted).

¹¹⁸ This dissertation will in Chapter 2.B.2.3 discuss how the SEC, given physical exit and threats of exit by FPIs as well as voice for liberalization by interest groups related to FPIs, allowed accommodation of home country regulations that would create an audit committee equivalent in independence to that envisaged under the U.S. rules—for instance, German firms are allowed to include labor representatives on the audit committee. Naturally, it was the international jurisdictional competition activated by FPIs’ exiting from U.S. stock markets that pushed the SEC to adopt a more flexible regime.

¹¹⁹ Joseph D. Piotroski & Suraj Srinivasan, *Regulation and Bonding: The Sarbanes-Oxley Act and the Flow of International Listings* 8-9 (Jan. 2008), available at <http://ssrn.com/abstract=956987> (alteration in original).

Act has been qualitatively significant. It is also regulation that makes no attempt to take into account the special needs of non-domestic issuers.”¹²⁰

2.2 The Effect of the Sarbanes-Oxley Act on Foreign Private Issuers

As commentators have said, SOX was poorly evaluated and hurriedly enacted during a regulatory panic. Most people now recognize that the direct compliance costs of SOX have been greater than expected. For example, as for SOX’s direct effect on the U.S. companies, compared with their UK counterparts after SOX, U.S firms’ risk-taking dwindled substantially. The declines had something to do with several measures, which include pre-SOX board structure, firm size, and R& D expenditures. In comparison with the UK, initial public offerings (“IPO”s) in the U.S. were apparently fewer and fewer after the enactment of SOX; the decline was especially higher for R&D intensive industries. The overall evidence confirms the assertion that public U.S. companies’ risk-taking is deterred by SOX.¹²¹

Moreover, SOX also reduces access to capital markets by the entrepreneurs U.S. markets depend on, especially FPIs. This indirect cost indicates the discouragement of foreign firms from trading in the United States, thereby eroding the U.S. dominance in world securities markets.¹²² This problem was also noted by the Supreme Court not long ago:

¹²⁰ Davidoff, *supra* note 113, at 132.

¹²¹ Leonce Bargerion, Kenneth Lehn & Chad J. Zutter, *Sarbanes-Oxley and Corporate Risk-Taking* (March 7, 2008), available at <http://ssrn.com/abstract=1104063>.

¹²² See Henry N. Butler & Larry E. Ribstein, *The Sarbanes Oxley Debacle: What We’ve Learned; How to Fix IT* (University of Illinois Law & Econ. Research Paper No. LE06-017, 2006), available at <http://ssrn.com/abstract=911277> (the abstract from the book published by AEI Press, 2006).

Adoption of petitioner's approach would expose a new class of defendants to these risks. As noted in *Central Bank*, contracting parties might find it necessary to protect against these threats, raising the costs of doing business. Overseas firms with no other exposure to our securities laws could be deterred from doing business here. . . . This, in turn, may raise the cost of being a publicly traded company under our law and shift securities offerings away from domestic capital markets.¹²³

Indeed, SOX imposes substantial costs on FPIs to which it applies. It is said that SOX significantly lessens the trading of foreign securities in the U.S. capital market. For example, John Thain, former CEO of the New York Stock Exchange (“NYSE”), expressed that new listings by FPIs declined to half the annual totals prior to SOX during two years subsequent to the passage of SOX, and that New York’s share of FPIs’ cross-listings fell from 90 % in 2000 to 10 % in 2005, largely due to the high costs SOX imposed on non-U.S. issuers.¹²⁴ Meanwhile, just when the United States, through SOX, increased costs imposed on smaller firms, London showed its regulatory advantage by providing these firms with a special low-cost market, Alternative Investment Market (“AIM”).¹²⁵

Furthermore, the latest report in the end of 2007 by the Committee on Capital Markets Regulation mentions that “[b]y any meaningful measure, the competitiveness of the U.S public equity market has deteriorated significantly in recent years.”¹²⁶ This

¹²³ *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 163-64 (2008) (citation omitted).

¹²⁴ Craig Karmin & Aaron Lucchetti, *New York Loses Edge in Snagging Foreign Listings*, WALL ST. J. (Jan. 26, 2006), available at http://online.wsj.com/article/SB113824819390656771.html?mod=todays_us_money_and_investing.

¹²⁵ Craig Karmin, *London Calling*, WALL ST. J. (Dec. 23, 2005), available at <http://online.wsj.com/article/SB113530126767530086-search.html?KEYWORDS=london+calling&COLLECTION=wsjie/6month/>.

¹²⁶ COMMITTEE ON CAPITAL MARKETS REGULATION, *THE COMPETITIVE POSITION OF THE U.S. PUBLIC EQUITY MARKET I* (2007).

deterioration can be observed, for example, from cross-listings in the U.S. and delistings by foreign companies. As for the former,

[t]raditionally, non-capital raising cross-listings by foreign companies reflect the desire to bond to high U.S. listing standards. These cross-listings in the U.S. have steadily declined to insignificance in 2007. Whereas 43 foreign companies cross-listed in the U.S. without raising capital in 2000, only 4 did so in 2007 through September. In 2006, 6 foreign companies cross-listed in the United States. The obvious inference is that foreign companies see diminishing value in bonding to U.S. standards.¹²⁷

When it comes to the latter,

[i]n 1997, just 12 foreign companies—3.9% of all listed foreign companies—opted to delist from the New York Stock Exchange. Foreign delistings rose to 30 in 2006—6.6% of all listed foreign companies. Through October 2007, a record 56 foreign companies (including major European companies)—or 12.4% of listed foreign companies—have delisted. The significant rise in the delisting rate in 2007 likely reflects a relaxation of SEC rules that previously had made delisting much more difficult. Some say this spike reflects a pent-up demand to leave and now will level off. That may be, but such a pent-up demand is itself a negative judgment on the value of using the U.S. public equity market.¹²⁸

There are mounting empirical studies to offer evidence of SOX's negative effects on FPIs. To name a few, according to Xi Li's work, responding to the enactment and enforcement of SOX, cross-listed FPIs get abnormal stock returns of -10%, on average, in both the U.S. and their home markets; however, Pink Sheets traded FPIs which need not comply with SOX are not impacted. Generally, better governed FPIs derive more negative abnormal returns. In comparison with the pre-SOX period, after SOX much

¹²⁷ *Id.* at 3.

¹²⁸ *Id.*

more cross-listed FPIs voluntarily delist and deregister to prevent the subjection to SEC reporting requirements. The abnormal returns at the “going dark” announcements are negative prior to SOX whereas these returns are positive in the post-SOX period. Overall, the evidence suggests that cross-listed FPIs are burdened with excessive compliance costs imposed by SOX.¹²⁹

Further, Susan Chaplinsky and Latha Ramchand have studied FPIs that delisted in the post-SOX period owing to the lesser likelihood that they have foreseen a shift in securities laws when they listed. Holding other factors constant, FPIs delisting in the pre-SOX period are significantly more likely to be from poor governance countries; however, it’s significantly more likely that those delisting in the post-SOX period are from good governance countries. Relative to firms that remain listed in the U.S. markets, FPIs voluntarily delisting without anticipating the enactment of SOX are smaller, less profitable firms with low growth, have lower analyst coverage, and take less advantage of capital-raising. 80% of the home markets of these FPIs caught off guard by SOX are developed and equipped with strong governance. It seems that these FPIs do not significantly benefit from U.S. listing while their home equity markets could practicably substitute for the U.S. markets, which thus caused those from good governance countries to exit from the U.S. markets.¹³⁰

Kate Litvak presented several works as direct evidence of whether SOX hurt foreign firms. For instance, to begin with, she showed that the premium that investors are willing

¹²⁹ Xi Li, *The Sarbanes-Oxley Act and Cross-Listed Foreign Private Issuers* (2nd Annual Conference on Empirical Legal Studies Paper, 2007), available at <http://ssrn.com/abstract=952433>.

¹³⁰ Susan Chaplinsky & Latha Ramchand, *From Listing to Delisting: Foreign Firms’ Entry and Exit from the U.S.* (May 2008), http://www.wlu.ca/documents/30478/delisting_may12_2008_wlu.pdf (last visited Sep. 30, 2008).

to pay for shares of foreign companies cross-listed in the U.S. associated with trading in the United States (FPIs cross-listed on Level I or IV) was roughly constant, whereas the premium concerned with being subject to U.S. regulation (FPIs cross-listed on Level II or III) diminished. FPIs that lost the most were those that were more profitable, riskier, and smaller, those with a higher degree of disclosure prior to SOX, and those from well-governed countries. As Litvak notes, “[t]hese results are consistent with the view that investors expected SOX to have greater costs than benefits for cross-listed firms on average, especially for smaller firms and already well-governed firms.”¹³¹ In addition, she finds:

stock prices of foreign firms subject to SOX declined (increased) significantly, compared to cross-listed firms not subject to SOX and to non-cross-listed firms, during key announcements indicating that SOX would (would not) fully apply to cross-listed issuers. In cross-sectional tests, high-disclosing firms and firms from high-disclosing countries experienced the strongest declines, while faster-growing companies experienced weaker declines. This evidence is consistent with the view that investors expected SOX to have a net negative effect on cross-listed foreign companies, with high-disclosing and low-growth companies suffering larger net costs, and faster-growing companies suffering smaller costs, particularly when they are located in poorly governed countries.¹³²

The studies discussed above display that FPIs subject to SOX are negatively impacted in terms of important losses of valuation premia, which might not be completely accounted for by the increased costs of direct compliance as these losses are significantly large. Her third study thus investigates one likely reason for the losses—the complaint that SOX deters FPIs’ risk-taking:

¹³¹ Kate Litvak, *Sarbanes-Oxley and the Cross-Listing Premium*, 105 MICH. L. REV. 1857, 1857 (2007).

¹³² Kate Litvak, *The Effect of the Sarbanes-Oxley Act on Non-US Companies Cross-Listed in the US*, 13 J. CORP. FIN. 195, 195 (2007).

I use three sets of proxies for risk: (1) volatility of returns . . . (2) financial leverage . . . and (3) cash hoarding I find evidence, across all measures, that the pair difference in risk declined significantly after SOX for [level-23-exposed foreign firms (that is, cross-listed companies listed on Level II or III and thus subject to SOX)] and did not decline for level-14 pairs, over the post-SOX period from 2003 through 2005. . . . High-Tobin's Q firms experienced stronger reductions in risk.¹³³

As she concludes,

[t]his evidence is consistent with the view that SOX negatively affected corporate risk-taking, and may have particularly affected firms that were already well-governed before SOX. It is also consistent with prior research finding significant declines in market valuations of SOX-exposed foreign firms; the magnitude of the declines cannot be fully explained by increased costs of compliance. The analysis in this paper offers a possible explanation for why investors may have reacted negatively to SOX.¹³⁴

According to the study by Joseph Piotroski and Suraj Srinivasan, subsequent to the passage and implementation of SOX, there was little change in large FPIs' preferences when they make a choice between American exchanges and the London Stock Exchange's ("LSE") Main Market. On the contrary, they find that after SOX small FPIs were less likely to engage in a U.S. listing in choosing between the NASDAQ and LSE's AIM. Since small FPIs has less ability to assume the increased costs imposed by SOX, SOX negatively affects them.¹³⁵ Also, based on Christopher Woo's work,

¹³³ Kate Litvak, *Defensive Management: Does the Sarbanes-Oxley Act Discourage Corporate Risk-Taking?* 4 (3rd Annual Conference on Empirical Legal Studies Papers; University of Texas Law School Law & Econ. Research Paper No. 108, 2008), available at <http://ssrn.com/abstract=1120971> (alteration in original).

¹³⁴ *Id.* at 5 (citation omitted).

¹³⁵ Piotroski & Srinivasan, *supra* note 119.

[t]here is some support for the proposition that European and East Asian issuers have been increasingly accessing U.S. markets [but] more stringent U.S. securities regulations may end this trend. . . . Even with the releases [of exemptions], [SOX] has led to some increased requirements for [FPIs] and will therefore have a somewhat deterrent effect on them.¹³⁶

SOX defenders might respond to these anti-SOX studies by saying that the deterioration of U.S. public equity market cannot all be attributed to SOX, and that this is partly a story of the rise of non-U.S. exchanges. For example, as Luigi Zingales explains,

the U.S. equity market share has dropped dramatically from 2000 to 2005. This drop cannot be explained by changes in the geographical or the sectoral composition of IPOs. The most likely cause is a combination of an improvement in the competitors (mostly European equity markets) and an increase in the compliance costs for publicly traded companies.¹³⁷

Supporters for SOX might also point out that it is primarily the riskier stocks that exit from the U.S. markets. For instance, Nuno Fernandes, Ugur Lel and Darius Miller indicate that after the SEC on March 21, 2007 adopted Exchange Act Rule 12h-6 which better enables FPIs to deregister and terminate the reporting requirements concerned with a listing on major U.S. exchanges, the U.S. stock markets evaluated as negative the ability of FPIs from countries whose disclosure and governance are weak to more easily opt out of the strict U.S. reporting and legal regime, and that in particular as investor

¹³⁶ Christopher Woo, *The Effects of the Sarbanes-Oxley Act on Foreign Private Issuers* 60 (seminar paper, Int'l Fin. Seminar, Harvard Law Sch.), http://www.law.harvard.edu/programs/pifs/pdfs/christopher_woo.pdf (last visited Sep. 24, 2008) (alteration in original).

¹³⁷ Luigi Zingales, *Is the U.S. Capital Market Losing Its Competitive Edge?* 1 (ECGI – Fin. Working Paper No. 192/2007, 2007), available at <http://ssrn.com/abstract=1028701>.

protections provided in FPIs' home countries are weak, their U.S. shareholders would value U.S. securities laws very highly.¹³⁸

Nonetheless, Craig Doidge, George Karolyi and Rene Stulz examined the attributes of 59 FPIs that immediately declared their potential deregistration after the adoption of the new SEC Rule 12h-6, what could have motivated them to do so, as well as what happened to them economically after such decisions. They find that before the decisions these firms grew significantly more slowly and gained lower stock returns than other U.S. exchange-listed FPIs. Weak evidence supports that FPIs in announcing deregistration derive negative stock returns; stronger evidence suggests that those with higher growth experience worse stock-price reactions. Examining stock-price reactions around events concerned with the enactment of SOX, they found negative stock-price reactions on average. Their evidence corroborates the hypotheses that FPIs cross-list in the U.S. with a view to raising capital at the lowest possible cost so as to financially support their growth opportunities, and that, as soon as those opportunities vanish, FPI's insiders place less valuation on cross-listings in the U.S. so that there is a higher likelihood that they would deregister and list back home.¹³⁹

Furthermore, an empirical study on the capital raising practices of Chinese companies found that all of the interviewees who were individuals possessing extensive experience in securities work in the U.S., Hong Kong, and China mentioned SOX as

¹³⁸ Nuno Fernandes, Ugur Lel & Darius P. Miller, *Escape from New York: The Market Impact of Loosening Disclosure Requirements* (EFA 2008 Athens Meetings Paper, 2008), available at <http://ssrn.com/abstract=1031398>.

¹³⁹ Craig Andrew Doidge, George Andrew Karolyi & Rene M. Stulz, *Why Do Foreign Firms Leave U.S. Equity Markets? An Analysis of Deregistrations Under SEC Exchange Act Rule 12h-6* (Fisher College of Business Working Paper No. 2008-03-013, 2008), available at <http://ssrn.com/abstract=1204442>.

“being particularly irritating to foreign issuers, because it goes beyond what has historically been the purview of U.S. financial securities regulation.”¹⁴⁰ This study further pointed out that “Chinese issuers find that public listings may not always generate a strong U.S. following,” and that “in order to avoid more stringent securities regulations, Chinese issuers often choose to list in Hong Kong [(one of the two major players in Asia while the other bigger one is Tokyo Stock Exchange)] instead of the U.S., with no significant repercussion.”¹⁴¹ This study shows that indeed FPIs have more stock exchanges outside the U.S., say, Hong Kong, to go to raise capital, but the problem is that, with SOX, the U.S. created a higher incentive for them to leave for other non-U.S. exchanges. This study also implies that even though it’s mainly the riskier stocks like those of Chinese issuers whose legal institutions of investor protection at home are relatively problematic,¹⁴² that exit from the American capital market, those stocks are still significant to the U.S. markets.¹⁴³

Finally, even if there has been controversy regarding the cause of the decline in cross-listings to some extent, the actual cause of the decline might not be that significant. Just as O’Hara and Ribstein note, “the actual effect of regulation is seldom clear. For the purpose of showing the political effect of exit on regulation, it is enough that the

¹⁴⁰ Erica Fung, *Regulatory Competition in International Capital Markets: Evidence from China in 2004-2005*, 3 N.Y.U. J. L. & Bus. 243, 263 (2006).

¹⁴¹ *Id.* at 299 (alteration in original).

¹⁴² See generally Donald C. Clarke, *The Ecology of Corporate Governance in China* (GWU Legal Studies Research Paper No. 433; GWU Law School Public Law Research Paper No. 433, 2008), available at <http://ssrn.com/abstract=1245803>.

¹⁴³ See Larry E. Ribstein, *The Latest News on SOX vs. US Capital Markets*, <http://busmovie.typepad.com/ideoblog/> (Dec. 10, 2007, 15:54 EST).

perception that the decline was attributable to regulatory cost triggered a demand to reduce the regulatory burden.”¹⁴⁴

2.3 Exit and Voice Nudge Exemptions

As explained above, the Congress in writing SOX and the SEC in the beginning had not been wary of the importance of maintaining legal flexibility requested by FPIs and respecting their business demands. Due to SOX’s heightened regulation over FPIs, the non-U.S. issuers in the post-SOX period have been cross-listing in other stock markets or voluntarily delist and deregister to avoid SEC reporting obligations. On the demand side of the cross-listing law market, they need to find a regulatory product of securities regulation which can bond their insiders but require lower compliance cost than the U.S. markets entail. Some improved markets such as LSE or HKSE are able to supply this type of regulatory product on the supply side. FPIs’ exercise of the “exit” option further strengthens their “voicing” complaints to the SEC. Under these law market forces at work, the SEC has adopted several exemptions to relax FPIs’ regulatory burdens and expects thus to retain FPIs in or attract them back to the U.S. stock markets. The exemptions of FPIs from SOX’s requirement of independent audit committees illustrate the regulatory transition from a strictly mandatory to more flexible regime.

Section 301 of SOX arguably imposes higher costs on FPIs than on U.S issuers with lower benefits. SOX’s requirement of independent audit committees and its assigning “to the audit committee all responsibility ‘for the appointment, compensation, and oversight of the work of any registered public accounting firm employed by that issuer (including

¹⁴⁴ O’HARA & RIBSTEIN, *supra* note 27, at 229.

resolution of disagreements between management and the auditor regarding financial reporting)''¹⁴⁵ would lead to a significant revolution for corporations incorporated under civil law regimes. Civil law countries, such as Germany, often require that there should be a two-tier board with a lower managing board and an upper supervisory board. The lower managing board cannot act as the audit committee because none of the members are independent as defined by SOX. Nevertheless, because the upper board is composed half of employees, corporations have tended not to give the board "significant substantive responsibilities."¹⁴⁶

Although FPIs have continued listing in the U.S., subsequent to the enactment of SOX they may start to hesitate to an extent. This phenomenon suggests that FPIs will take the exit option as a response to SOX. For instance, citing problems with SOX, Porsche has decided not to list shares in the U.S. and announced that it would not change its mind even after the proposed exemptions were adopted. Likewise Benfield Group Ltd, also citing SOX, has made a decision to list shares in London rather than in the United States.¹⁴⁷ Daiwa Securities deferred its scheduled listing activity in 2002 to observe how the new regulations would turn out.¹⁴⁸ Nippon Telegraph and Telephone took delisting into account while LVMH determined a delisting.¹⁴⁹

Facing up to this problematic regulation and motivated by FPIs' exit, anti-regulatory and exit-affected interest groups associated with FPIs have attempted to voice their

¹⁴⁵ John C. Coffee, Jr., *Racing Towards The Top?: The Impact of Cross-listings and Stock Market Competition on International Corporate Governance*, 102 COLUM. L. REV. 1757, 1825-26 (2002).

¹⁴⁶ *Id.* at 1825.

¹⁴⁷ See Craig Karmin & Kevin J. Delaney, *SEC's Exemption Gets Some Praise*, WALL. ST. J., Jan. 13, 2003, at C16.

¹⁴⁸ See Mariko Sanchanta, *Daiwan Shelves NYSE Listing Plan*, FIN. TIMES (LONDON), Oct. 26, 2002, at 8.

¹⁴⁹ Woo, *supra* note 136, at 19.

complaints. For instance, Sullivan & Cromwell (UK) argued that home country laws in some other jurisdictions to which FPIs are subject may entitle shareholders or another body to the power to select and supervise auditors.¹⁵⁰ France Telecom argued that some entities in foreign governments are required to be a member of the audit committee for certain FPIs.¹⁵¹ Furthermore, Linklaters argued that the SEC has not considered protections provided by foreign law, that the German Corporations Act restrains a parent company from doing something at the expense of its subsidiaries' benefits, and that it is thus unnecessary not to permit representatives from the parent company to vote on the audit committee of its subsidiary.¹⁵² Given potential conflicts from Section 301 as well as other sections of SOX, the European Commission filed a comment letter to make an appeal that there should be exemptions for European issuers from the requirements of SOX. The above comments demonstrate not only that “[w]ithout exemptions many foreign private issuers might find it hard to comply simultaneously with Section 301 and home country regulations,”¹⁵³ but also that FPIs, perceiving excessiveness of the post-SOX cross-listing regulatory product, attempt to exercise their voice rights, that is, to improve the relationship with the U.S. stock markets through communication of the complaint or proposal for change.

In addition, the NYSE, one of the exit-affected interest groups, might be conscious of the problem with which SOX may burden foreign issuers and wrote to the SEC in the

¹⁵⁰ See Comments of Sullivan & Cromwell (UK) on File No. S7-21-02 (Oct. 11, 2002), at <http://www.sec.gov/rules/proposed/s72102/sullivanuk1.htm> (last visited Nov. 11, 2008). See also Comments of Telefonaktiebolaget LM Ericsson on File No. S7-02-03, at <http://www.sec.gov/rules/proposed/s70203/ericsson1.htm> (last visited Nov. 7, 2008).

¹⁵¹ See Comments of France Telecom on File No. S7-02-03 (Feb. 18, 2003), at <http://www.sec.gov/rules/proposed/s70203/rctreuhold1.htm> (last visited Nov. 11, 2008).

¹⁵² See Comments of Linklaters on File No. S7-02-03 (Feb. 18, 2003), at <http://www.sec.gov/rules/proposed/s70203/linklaters1.htm> (last visited Nov. 11, 2008).

¹⁵³ See Woo, *supra* note 136, at 18.

comment period. It stated that it was “aware of a number of companies that are considering either delisting (to avoid compliance with the audit committee requirements) or delisting and deregistration (to avoid compliance with these and certain other provisions of [SOX]) [in particular provided that they] have not yet achieved a significant U.S. shareholder base.”¹⁵⁴ It noted that companies such as the Benfield Group has chosen to list shares in London instead and that “[t]he London Stock Exchange has been quite openly using the regulatory hurdles associated with [SOX] as a marketing wedge against U.S. registration and listing.”¹⁵⁵ The comment letter further stressed that SOX has led to “foreign regulators, companies and media questioning the right of Congress to change the rules for non-U.S. listed companies ‘in the middle of the game.’”¹⁵⁶ Particularly, the NYSE supported the accommodation for controlling shareholders, for foreign governments, and for employee representatives. The NYSE also extended support to a proposed exemption of auditor oversight via some body other than the audit committee. What’s more, the NYSE might intend not to ask FPIs to comply with its additional independence requirements.¹⁵⁷

Therefore, the SEC has been wary of how SOX would potentially discourage FPIs, and considering how to moderate conflicts between SOX and FPIs’ home country regulations and practices for some time. On January 8, 2003, it proposed rules on Section 301, entitled “Standards Relating to Listed Company Audit Committees,” including some

¹⁵⁴ See Comments of New York Stock Exchange, Inc. on File No. S7-02-03 (Feb. 21, 2003), at <http://www.sec.gov/rules/proposed/s70203/dcstuckey1.htm> (last visited Nov. 11, 2008) (alteration in original).

¹⁵⁵ *Id.* (alteration in original).

¹⁵⁶ *Id.*

¹⁵⁷ Woo, *supra* note 136, at 20.

exemptions from the audit committee requirement for FPIs.¹⁵⁸ After receiving comment letters, such as those mentioned above, written in response to the proposed rules for “Standards Relating to Listed Company Audit Committees,” the SEC made a decision to broaden some of its proposed exemptions.¹⁵⁹ The Final Release, implementing Section 301 of SOX, did give a few exemptions to FPIs. The Release clearly states that the SEC has “long recognized the importance of the globalization of the securities markets both for investors who desire increased diversification and international companies that seek capital in new markets.”¹⁶⁰ The SEC realizes that U.S. investors progressively desire to make investments in foreign securities and tries to make sure that the announced new rules will not unduly burden FPIs. The Release emphasizes that although Section 301 does not differentiate between foreign and domestic issuers while the adoption of audit committees is a growing trend, the SEC will grant such exemptions and clarifications that FPIs will not be required to abide by legal rules in conflict with regulations in their home countries.¹⁶¹

2.4 Summary

The negative effect of SOX on FPIs has triggered a political dynamic that may have far-reaching consequences. In the beginning, “[a]voidance by non-U.S. firms of the U.S.

¹⁵⁸ Standards Relating to Listed Company Audit Committees, Securities Act of 1933, Securities Exchange Act of 1934, and Investment Company Act of 1940, Release No. 8173, Release No. 25885, Release No. 47137, Release No. 33-8173, Release No. 34-47137, Release No. IC-25885, 17 C.F.R. Parts 228, 229, 240, 249 and 274 (2003).

¹⁵⁹ For a summary of the comments received, *see* Summary of Comments: Related to Proposed Standards Relating to Listed Company Audit Committees, http://www.sec.gov/rules/extra/s70203summary.htm#P1123_88469 (last visited Nov. 8, 2008).

¹⁶⁰ Standards Relating to Listed Company Audit Committees, Securities Act of 1933, Securities Exchange Act of 1934, and Investment Company Act of 1940, Release No. 8220, Release No. 47654, Release No. 33-8220, Release No. 34-47654, Release No. IC-26001, 17 C.F.R. Parts 228, 229, 240, 249 and 274, § II.F.3.a, at 25.

¹⁶¹ *Id.*

market may reduce U.S. investors' ability to diversify their portfolios. . . . [T]his avoidance may reduce the revenues of US securities firms [as well as other exit-affected parties], thereby provoking these firms to lobby for reducing the regulatory burden on cross-listing firms.”¹⁶² Thereafter, the U.S. responded to criticisms from German companies and other groups by issuing rules that partially exempt foreign firms from some SOX requirements. Perhaps more importantly, as Butler and Ribstein discuss,

[t]hese rules raise the question of how far the SEC can go in exempting foreign firms before triggering significant complaints from their U.S. competitors in the U.S. capital markets. The exemptions undoubtedly are attributable to some extent to the fact that foreign firms are much better able to exit [from] the U.S. market than U.S.-based firms. The latter may be subject to U.S. laws even if they trade overseas, and they have other business reasons for needing to trade in the United States. To the extent the exemptions are, or should be, based on the costs of compliance, they arguably should apply to any firm that is incorporated under and must comply with the corporate law of another country, regardless of where the corporation's operations are based. But any such exemption would invite U.S. firms to avoid U.S. law by incorporating elsewhere. To the extent that such competition forces U.S. regulators and legislators to reassess the damage they have done to American securities markets, such exits by U.S. firms could ultimately help correct the SOX mistake.¹⁶³

In other words, the SEC will face pressure from U.S.-based firms, who would use their “greater” voice in the U.S. political marketplace to lobby for exemptions similar to those granted to FPIs, to extend benefits of foreign exemptions to domestic firms.¹⁶⁴ In fact, “in the wake of [SOX], many of the reforms passed to [foreign] issuers have been

¹⁶² Ribstein, *supra* note 115, at 323 (alteration in original).

¹⁶³ BUTLER & RIBSTEIN, *supra* note 109, at 74 (alteration in original).

¹⁶⁴ See Ribstein, *supra* note 51, at 130-39. See also Donald C. Langevoort, *The SEC, Retail Investors, and the Institutionalization of the Securities Markets*, 95 VA. L. REV. 1025, 1077 (2009).

ultimately shared by U.S.-domiciled companies or are in the process of being considered for extension to U.S. companies.”¹⁶⁵ That is, exit could lead to general deregulation.¹⁶⁶

In general, the phenomenon of SOX and the global cross-listing market discussed above demonstrates some dimensions of the law market:

First, it shows how even what would seem to be the most mandatory laws must compete in the law market given the increasingly global nature of competition. This competition can increase the level and quality of regulation, as shown by the rise of cross-listing firms. Second, SOX’s aftermath indicates that regulated firms may exit in the face of increased regulatory costs. Third, this history shows how the financial impact of exit on interest groups in regulating countries ultimately can cause states to make changes in their laws that reduce regulatory costs. Although these changes may be provoked by the most mobile firms, they have the potential of reducing costs for all firms, including those that have higher costs of exit.¹⁶⁷

In conclusion, in this law market for cross-listings we see “the usual law market forces could work for securities regulation, just as U.S. states ultimately came to apply the IAD to tramp corporations.”¹⁶⁸ On the buy side of this law market, “regulation and non-enforcement of contractual choice of law create an incentive to leave,” and on the sell side “exit activates local industries that depend on the exiting firms; “[t]his, in turn, pressures politicians to enable jurisdictional choice, sometimes even for immobile locals.”¹⁶⁹ In other words, feedbacks of exit and voice rights are translated into the regulatory evolution for the SEC to moderate the over-burdensome regulation imposed by SOX. This SOX case thus implies not merely that “the elements of the law market story

¹⁶⁵ Chris Brummer, *Corporate Law Preemption in an Age of Global Capital Markets*, 81 S. CAL. L. REV. 1067, 1105 (2008) (alteration in original).

¹⁶⁶ Ribstein, *supra* note 115, at 325-26.

¹⁶⁷ O’HARA & RIBSTEIN, *supra* note 27, at 31.

¹⁶⁸ *Id.* at 124 (footnote omitted).

¹⁶⁹ Ribstein & O’Hara, *supra* note 8, at 711-12.

apply in the international context,”¹⁷⁰ but also that law market forces underlying international jurisdictional competition would provoke a change in excessive regulation to a more flexible regime.¹⁷¹

¹⁷⁰ *Id.* at 712.

¹⁷¹ Alan Dignam and Michael Galanis also seem to confirm this conclusion:

One can further observe the continuing importance of macroeconomic pressures in the problems that the NYSE has had since the introduction of [SOX] in response to the Enron and WorldCom scandals. In a continuation of the regulatory competition created by capital mobility . . . since 2002 the NYSE has been losing out to the LSE for new listings because of the onerous nature of SOX. Because of capital mobility, companies around the world, including US companies, can simply choose to avoid the US regulatory regime when raising capital. As a result, the SEC in May 2007 produced new guidance on interpreting the most contentious aspects of SOX, with the intention of making it less burdensome.

Alan J. Dignam & Michael Galanis, *Corporate Governance and the Importance of Macroeconomic Context*, 28 OXFORD J. LEGAL STUD. 201, 242 (2008), available at <http://ssrn.com/abstract=1154412> (alteration in original) (footnote omitted).

CHAPTER 3: JURISDICTIONAL COMPETITION AMONG GLOBAL LEGAL CENTERS

On the other side of the Pacific Ocean, even if Taiwan and Mainland China are highly economically interdependent on each other, there is some political antagonism between them.¹⁷² Therefore, facing its flourishing economic relationship with Mainland China since the late 1980s, Taiwan's government is in a dilemma of whether and how to regulate the investments of the Taiwanese business community in China. But with Taiwan's government attempting unsuccessfully to hinder further cross-Strait investment, many Taiwanese corporations have weaved their ways through these bans in order to hand over needed funds to their affiliates or subsidiaries in Mainland China. This Taiwan phenomenon seems also to exemplify international jurisdictional competition among global legal centers, referring especially to Hong Kong and other OFCs in British Central America (e.g. the Cayman Islands). In effect much evidence to date reveals that this jurisdictional competition provoked by Taiwanese companies' exit to elude the Restrictions prompts substantial ease of capital limits placed by Taiwan's government. Chapter 3.A first through a more micro-level account illustrates this jurisdictional competition in which the above OFCs participated by elaborating on the law market for listings in the Greater Chinese Economy mainly led by HKSE as a competitor against Taiwan. Chapter 3.B further offers a bird's eye view of how the international jurisdictional competition among global legal centers plays a role in causing the lightening of the Capital Controls: Business demands for increasing investment in China

¹⁷² Chien-Min Chao, *Will Economic Integration between Mainland China and Taiwan Lead to a Congenial Political Culture?*, 43 *ASIAN SURV.* 280, 280 (2003).

(demonstrated by the surge of China-investment) under economic globalization coupled with the fact that the international jurisdictional competition (mainly spurred by the denationalization of financial capital) sent the Capital Controls ineffective, as discussed below, could be attributable to the stage-by-stage liberalization in question.

A. Jurisdictional Competition among Listing Markets in the Greater Chinese Economy: Hong Kong as an Example of Competitors against Taiwan

General law market forces are also at work in the law market for listings in the Greater Chinese Economy as in the law market for cross-listings explained above. In concrete terms, on the demand side, the Restrictions create incentives of China-based Taiwanese businesses to exit from Taiwan stock markets and their demands to find a regulatory product of securities regulation without being subject to the Restrictions. On the international supply side, neighboring stock markets in the Greater Chinese Economy, not least Hong Kong Stock Exchange (“HKSE”), supply this product of legal flexibility. On the domestic supply side, a torrent of physical exit by these fugitive companies activates local industries and interest groups that depend on the exiting firms. Subsequent to interest group competitions over whether or how to relax the related restrictions, anti-regulatory and exit-affected interest groups successfully voice their petition for liberalization. Therefore, the jurisdictional competition among listing markets in the Greater Chinese Economy, through Taiwanese firms’ exit and voice, pressures politicians in Taiwan to satisfy business demands for legal flexibility, or to loosen the relevant bans on outwardly investing in Mainland China.

1. The Demand Side of the Law Market

1.1 The Restrictions on Outward Investment in Mainland China

1.1.1 The Background of the Capital Controls

Historically, since China started opening up during the 1980s, Taiwan-invested firms have been one of the first companies which invested a lot on the Mainland and have already made a fortune. As Bradsher reported in 2007, “[e]stimates of total Taiwan holdings on the mainland run as high as \$280 billion.”¹⁷³ Taiwan’s local economy has in some sense benefited from China-investment in the past few years. Why have Taiwanese firms been increasingly investing in China during these years? A higher degree of political antagonism existed between Taiwan and China prior to 1979. There were all but no business connections between them. In 1979, however, the fact that China changed its mind from liberating Taiwan to calling for peaceful unification made an important change. As Taiwan suddenly allowed its citizens to visit their relatives on the Mainland in October 1987, cross-Strait economic relations were further developed. More importantly, representatives of China’s Association for Relations Across the Taiwan Strait (“ARATS”) and Taiwan’s Straits Exchange Foundation (“SEF”) 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.”¹⁷⁴

¹⁷³ Bradsher, *supra* note 2.

¹⁷⁴ Ping Deng, *Taiwan’s Restriction of Investment in China in the 1990s: A Relative Gains Approach*, 40 *ASIAN SURV.* 958, 962 (2000).

What follows summarizes what drove cross-Strait trade and investments from Taiwan to China to turn out to be a torrent. First of all, Taiwan's democratization drive was also responsible for this trend. Second, the financial liberalization followed substantial appreciation of the New Taiwan ("NT") dollar resulting from the Plaza Accord. The NT dollar's value increased, thus making manufacturing in Taiwan less competitive and lessening Taiwanese exporters' profits. Taiwanese firms, to remain internationally competitive, started to make large investments on the Mainland, which attracted much of the manufacturing and exporting activities originally based in Taiwan. Another crucial factor was the decrease of cross-Strait political tension as shown above. In addition, the justification for Taiwanese investment mainly rests on comparative advantages as well as economic complementarities. Taiwan's plentiful funds and improved 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, primarily contribute to capital flow from Taiwan to China. Last but not least, Taiwanese firms would lose the market to rivals like South Korea, if not for relocating their factories to China.¹⁷⁵

Even though cross-Strait economic interactions have turned really intense, officials of Taiwan's government kept struggling to impede the fast development of business connections. In September 1996, President Teng-Hui Lee stressed a "No Haste, Be Patient" investment policy (the "NHBP" policy) while requiring Taiwanese firms to brake their rapid expansion of Mainland operations. He emphasized that Taiwan would become susceptible to Chinese political pressure with greater cross-Strait economic

¹⁷⁵ *Id.* at 962-64.

interdependence. The Council for Economic Planning and Development (“CEPD”), the official think tank of Taiwan’s government, at the same time withdrew a suggestion to lighten restrictions on China-investment.¹⁷⁶ The following July, the Ministry of Economic Affairs (“MOEA”) released its revised Principles Governing the Review of Investment or Technical Cooperation in Mainland China (the “Principles”). What should be noted is that the cap amount of investment is specified in Article 3 of the Principles, which is 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 \$50 million, and imposed a general system to limit Taiwanese firms’ investments in the PRC according to their overall financial exposure and ownership structure (the “Capital Controls”).¹⁷⁷

1.1.2 The Legal Basis of the Constraints

Although Taiwan has turned to large-scale deregulation¹⁷⁸ since President Ma of KMT won the presidential election in March 2008, prior to this notable legal change

¹⁷⁶ *Id.* at 965-66.

¹⁷⁷ See Fu-Lung Lee, *Tai Shang Zai Da Lu Shang Shi De Zheng Ce Yu Fa Lü Ji Qi Yin Ying Zhi Dao* [On Policy, Law and the Suggestion for Taiwanese Enterprise to Go Public in the Mainland Area], 34 TAIWAN DA XUE FA XUE LUN CONG [NTU L. J.] 277, 279-80 (2005) (Taiwan).

¹⁷⁸ See, e.g., Shu-Fang Huang, *Deng Lu Tou Zi Shang Xian Fang Kuan Zhi Bai Fen Zhi Liu Shi Zong Bu Zai Tai Zhe Bu She Xian* [The Capital Cap on Investment in China Is Relaxed to 60 % while No Cap Is Applied if Administrative Centers Are Established], ZHONG YANG SHE JI SHI XIN WEN [CENTRAL NEWS AGENCY NEWS], July 15, 2008, <http://news.msn.com.tw/print.aspx?id=862620> (last visited July 15, 2008); Yi-Feng Lin & Gui-Xiang Wen, *Zong Tong Hui Wu Liu Kui Qiao Ding Deng Lu Tou Zi Shang Xian Song Bang* [President Met Premier and Decided for the Relaxation of the Capital Cap], ZHONG YANG SHE JI SHI XIN WEN [CENTRAL NEWS AGENCY NEWS], July 14, 2008, <http://news.msn.com.tw/print.aspx?id=862618>

MOEA maintained the Capital Controls that the total dollar amount of direct and indirect investment in Mainland China cannot exceed the upper limits, generally 40% of a Taiwanese firm's net worth. In order to thoroughly implement the Capital Controls, Taiwan's government further imposed several constraints through administrative regulations to restrain Taiwanese and even foreign issuers from investing funds raised in Taiwan stock markets outwardly in Mainland China (the "Constraints"). First, according to Article 7 of Regulations Governing the Offering and Issuance of Securities by Securities Issuers, Taiwanese issuers were not allowed to directly or indirectly invest any capital raised in Taiwan stock markets in Mainland China. Second, the predecessor organization of the Financial Supervisory Commission ("FSC") in Taiwan, equivalent to the SEC in the U.S., also released an administrative regulation to prohibit public Taiwanese companies from investing capital raised through private placements, no matter in Taiwan or overseas, in Mainland China.¹⁷⁹ Third, Article 9 of Regulations Governing the Offering and Issuance of Overseas Securities provided that the fund raised from the issuance of securities in overseas stock markets was not allowed to be used for direct or indirect investments in Mainland China beyond the upper limit, 20-40% of the amount of the fund raised in each offering. Fourth, Regulations Governing the Offering and Issuance of Securities by Foreign Securities Issuers stipulated that neither could funds raised in Taiwan stock markets by foreign issuers be used for investments in Mainland China.

(last visited July 15, 2008).

¹⁷⁹ Order of Securities and Futures Commission, Ministry of Finance, Executive Yuan, Tai-Cai-Zheng-Yi Zi No. 09100168912 (passed Jan. 17, 2003). See also *Shang Shi Gong Si Si Mu Zi Jin Ke Yi Tou Zi Lu Gu Shang Xian Bai Fen Zhi Liu Shi* [Listing Corporations Can Invest Up to 60% of Capital Raised through Each Private Placement in Buying Chinese Stocks], FA YUAN FA LÜ XIN WEN [LAWBANK'S L. NEWS] (Taiwan), Oct. 9, 2008, <http://www.lawbank.com.tw/fnews/pnews.php?nid=64123.00> (hereinafter *Placements*) (last visited Oct. 9, 2008).

In addition, it should be noted that foreign issuers in Taiwan may be classified into two groups: one group, having not listed their shares on any other stock exchanges abroad, applies for listing shares in Taiwan stock markets (“Primary Listing Issuers”) while the other group, with securities being traded on stock exchanges abroad, applies for the listing of Taiwan Deposit Receipts (“TDR”s) in Taiwan stock markets (“Secondary Listing Issuers,” the equivalent of cross-listing issuers in the U.S. stock markets).

1.2 Problems of the Restrictions: Strong Intention but Weak Capability of Enforcement

1.2.1 Ignoring Economic Globalization and Business Demands

The Restrictions apparently ignore Taiwanese firms’ business demands created by economic globalization. Cross-Strait economic relations may have been treated as an issue of excessive politicization, with little economic reasoning, for policy making in Taiwan. From the perspective of economic statecraft¹⁸⁰ favored by the pro-regulatory interest groups, Taiwanese investment in Mainland China has a negative impact on Taiwan’s economic development; the primary one is the emptying out of Taiwan’s labor intensive industries as well as the flowing away of Taiwan’s industrial competitiveness to China. Taiwanese Direct Investment (“TDI”) in China “may increase Taiwan’s

¹⁸⁰ No matter in which form the economic regulation is imposed, economic statecraft is *per se* a kind of intervention in the law of comparative advantage of international economy and trade. That is, in order to reach expected political goals, the power of a state is wielded against market mechanisms. Tse-Kang Leng, *Cong Mei Guo Dui Nan Fei De Jing Mao Guan Zhi Tan Tao Wo Dui Da Lu De Jing Mao Zheng Ce* [Research on Taiwan’s Policy on Economic Relations with Mainland China in Light of U.S. Economic Regulation on South Africa], 41 ZHONG GUO DA LU YAN JIU [MAINLAND CHINA STUDIES] 17, 17 (1998) (Taiwan).

vulnerability and sensibility to the Mainland's 'economic warfare'.¹⁸¹ Put differently, "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] policy aims."¹⁸² Nonetheless, it is a natural trend of economic globalization that accounts for the gradual growth of investment by Taiwanese companies on the Mainland.¹⁸³

Growing Taiwanese Investment in the PRC and intensified trade across the Strait is [sic] part of larger East Asian and global economic trends. East Asian firms became increasingly tied to the dynamism of China in the 1990s. In its May 2001 *White Paper on Trade*, Japan's Ministry of Economic Trade and Industry analyzed how China emerged as the center of growth in East Asia. China's share of East Asian GDP grew from 25% in 1980 to 37% in 1999. This phenomenon was driven in large part by two key trends: PRC liberalization of tariffs and investment opportunities and a large influx of [foreign direct investment ("FDI")]. Competition intensified significantly in East Asia in the 1990s with the quadrupling of FDI into the region, further liberalization of trade and investment barriers, and the subsequent cross-border specialization occurring in the region as evidenced by the rapid growth in the trade of intermediate goods.¹⁸⁴

Accordingly, as Sutter further 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."¹⁸⁵ In a

¹⁸¹ Tse-Kang Leng, *Securing Economic Relations Across the Taiwan Straits: New Challenges and Opportunities*, 11 J. CONTEMP. CHINA, 261, 262 (2002).

¹⁸² Tain-Jy Chen & C.Y. Cyrus Chu, *Cross-Strait Economic Relations: Can They Ameliorate the Political Problem?*, in TAIWAN'S PRESIDENTIAL POLITICS: DEMOCRATIZATION AND CROSS-STRAIT RELATIONS IN THE TWENTY-FIRST CENTURY 215, 221 (Muthiah Algappa ed., 2001) (alteration in original).

¹⁸³ YAN-ZHI ZHU, LIANG AN JING MAO [CROSS-STRAIT ECONOMIC AND TRADE RELATIONSHIP] 31 (2006) (Taiwan).

¹⁸⁴ Karen M. Sutter, *Business Dynamism across the Taiwan Strait: The Implications for Cross-Strait Relations*, 42 ASIAN SURV. 522, 527 (2002) (alteration in original) (footnote omitted).

¹⁸⁵ *Id.* at 534.

word, TDI in China “is a part of the global division of labor.”¹⁸⁶ Obviously, 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.

To be concrete, first of all, as Stiglitz puts it, globalization can be understood as “the closer integration of countries and peoples of the world which has been brought about by the enormous reduction in the costs of transportation and communication, and the breaking down of artificial barriers to the flow of goods, services, capital, knowledge, and (to a lesser extent) people across borders.”¹⁸⁷ When it comes to globalization at work across the Strait, for instance, “exchange of human capital is the most intimate form of international commerce, and, despite political differences, economic globalization has added this dimension to cross-Strait relations.”¹⁸⁸ Discussing the causes and process of the mobility of advanced talent between Taiwan and China, as well as its impact on cross-Strait relations, Tse-Kang Leng argues that “[e]conomic globalization, demonstrated by new waves of Taiwanese investment and the formation of global Information Technology (IT) production networks with the U.S., is the major impetus behind talent flows between Taiwan and China,” that “cross-Strait talent interaction is boosted by Taiwanese investment in China’s metropolitan areas such as Shanghai and by financial instruments such as [venture capital],” and that “human capital flows across the

¹⁸⁶ Chen-Yuan Tung, *The Impact on Taiwan*, in THE GLOBALIZATION OF THE CHINESE ECONOMY 190, 201 (Shang-Jin Wei, Guanzhong James Wen & Huizhong Zhou eds., 2002).

¹⁸⁷ JOSEPH E. STIGLITZ, GLOBALIZATION AND ITS DISCONTENTS 9 (2002).

¹⁸⁸ Tse-Kang Leng, *Economic Globalization and IT Talent Flows across the Taiwan Strait: The Taipei/Shanghai/Silicon Valley Triangle*, 42 ASIAN SURV. 230, 230 (2002).

Taiwan Strait are facilitated by the networking of production through international channels, especially through high-tech centers located in the U.S.”¹⁸⁹

Second, Chang & Goldstein note that “cross-Strait trade and investment were intimately linked,” that “[u]nderlying the dramatic growth of trade in the [period as early as prior to China’s and Taiwan’s accession to the WTO in 2002] was a related, and equally significant, evolving cross-Strait division of labor,” and that this international specialization “was driven by a parallel and similarly-rapid growth of investment by Taiwanese companies on the mainland, which began in the late 1980s.”¹⁹⁰ In addition, according to a study on TDI tendency, Taiwanese firms prefer investing in areas with similar business customs as well as cultural and linguistic affinity to Taiwan, in the sense that investment destinations with these characteristics show less investment risks (the “mental” factor). Moreover, Taiwanese firms’ international competitive edges rest on Taiwan’s networking with production through international channels (the “network” factor). These two factors contribute to Taiwanese firms’ investing in the PRC. When the international production network requests setting up bases of manufacturing in Mainland China, Taiwanese firms cannot resist this request in that if they are unable to interact well with the international production network, they will lose their position in this network.¹⁹¹ For instance, many multi-national corporations (“MNC”), such as Dell Computers, outsource their manufacturing to Taiwanese firms while asking them to establish factories

¹⁸⁹ *Id.* at 231 (alteration in original).

¹⁹⁰ 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 (Julian Chang & Steven M. Goldstein eds., 2007).

¹⁹¹ Tain-Jy Chen & Yinh-Hua Ku, *Quan Qiu Hua Xia Tai Shang Dui Da Lu Tou Zi Ce Lue* [*Investment Strategies of Taiwanese Firms in China during Globalization*], in *JING JI QUAN QIU HUA YU TAI SHANG DA LU TOU ZI: CE LÜE BU JU YU BI JIAO* [ECONOMIC GLOBALIZATION AND TAIWAN’S INVESTMENT STRATEGIES IN CHINA] 13, 13, 35 (Te-Sheng Chen ed., 2008) (Taiwan).

in the PRC given lower production costs and large consumer markets so as to directly ship products to customers in China and worldwide.¹⁹² In order to follow this international industrial specialization, Taiwanese firms have no other choice but to make large investments in China.

Third, subsequent to the entry into the WTO of both Taiwan and China, “growing business pressures and WTO commitments are converging in a way that would add pressure for . . . significant reductions in barriers to trade and investment in both the PRC and Taiwan.”¹⁹³ The gradual breaking down of trade and investment barriers means that Taiwan will and need to fit in with the international division of labor. Faced with the trend of globalization and international specialization, Taiwan is required to take into account the production resources and vast markets located in China, which drives Taiwanese firms to invest more in China.¹⁹⁴ Put differently, market incentives—economic globalization as well as China’s and Taiwan’s accession to the WTO—dominate cross-Strait economic interaction. Under economic globalization, in order to maintain their core competence, MNCs which confront more intense competition worldwide outsource other sectors not indentified as core business. This strategy results in more sophisticated international specialization. Since Mainland China has not only abundant resources such as labor and land but also a large potential domestic market,

¹⁹² 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).

¹⁹³ Sutter, *supra* note 184, at 530.

¹⁹⁴ See Bing-Zhong Lin, *WTO Quan Qiu Hua Yu Liang An Jing Mao Jing He* [WTO, Globalization and Cross-Strait Economic Co-opetition], 25 TAIWAN JING JI YAN JIU YUE KAN [TAIWAN ECON. RES. MONTHLY] (ISSUE 1) 64, 67 (2002) (Taiwan); also Horng-Ming Tsai & Koong-Lian Kao, *You Quan Qiu Jing Ji Zheng He Jing Yan Kan Liang An Jing Mao Hu Dong Xin Jia Gou* [The New Framework of Cross-Strait Economic Interaction in Light of the Experience in Global Economic Integration], 1 GUO JIA ZHENG CE LUN TAN [NAT’L POL’Y F.] (ISSUE 10) 39, 50 (2001) (Taiwan).

MNCs believe that China will play an increasingly important role in the international specialization. Especially after China's entry into the WTO, MNCs will highlight China's significance in global operation. As a result, economic globalization (in particular demonstrated by Taiwan's removal of trade and investment barriers intended for the entry into the WTO) and market inducements offered by the accession to the WTO to engage in international division of labor have been boosting Taiwanese firms' demands for active investment in China for the past few years.¹⁹⁵

In summary, under economic globalization, as Sutter points out,

[f]urther cross-Strait economic integration and specialization seem inevitable given the highly complementary nature of the economies of the PRC and Taiwan. Despite the tendency to see relations as zero-sum, both the PRC and Taiwan share a convergence of economic interests. For example, both are highly dependent on an open U.S. market, especially for jointly developed PRC-Taiwan exports. A large percentage of PRC exports to the U.S. (both via the PRC directly and Hong Kong indirectly) are exported by Taiwan-invested firms. While statistically Taiwan's exports appear to depend less on the U.S. market, in fact they depend on the health and openness of the U.S. market more than ever via their investments in the PRC. Many products that the U.S. used to import directly from Taiwan are now imported indirectly via Taiwan-invested firms in the PRC.¹⁹⁶

In other words, in spite of the Restrictions, market forces—economic globalization and cross-Strait specialization—drive the surge of TDI in China. Taiwan's regulation of TDI in China seems incapable of thwarting the operation of market incentives. At best, the Restrictions delay or force underground TDI in China. As discussed above, Taiwanese

¹⁹⁵ See Charng Kao, *Zong Tong Da Xuan Hou Liang An Jing Mao Guan Xi Zhan Wang* [*The Prospect of Cross-Strait Economic Relations after the Presidential Election*], 2 ZHAN WANG YU TAN SUO [PROSPECT & EXPLORATION] (ISSUE 5) 13, 16-17 (2004) (Taiwan).

¹⁹⁶ Sutter, *supra* note 184, at 538.

firms do have their strong demands for investing in China and further for legal flexibility of the regulation on outward investment in China. Nonetheless, due to the Restrictions, on the one hand, Taiwan is incapable of being properly integrated into the system of international specialization. In this case, Taiwan cannot exploit its competitive advantage and might thus be trapped in a bottleneck in economic development.¹⁹⁷ On the other hand, 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.¹⁹⁸

1.2.2 High Enforcement Costs of the Restrictions

1.2.2.1 Pervasive Evasion of the Restrictions

Many Taiwan-invested firms have funneled funds to China through their affiliates or subsidiaries incorporated in third countries like the Cayman Islands in order to skirt the investment restrictions, laid down by Taiwan’s government in 1997 subsequent to a wave of investment in China.¹⁹⁹ To be concrete, regardless of these obstacles, Taiwanese capital, goods, and know-how kept flowing across the Strait, in many cases indirectly via Hong Kong. Obviously, the investment restrictions urged Taiwanese firms to incorporate overseas in Hong Kong or other OFCs such as the Cayman Islands and the British Virgin Islands (“BVI”). As Sutter finds,

¹⁹⁷ Lin, *supra* note 194, at 70.

¹⁹⁸ Szu-Yin Ho & Tse-Kang Leng, *Accounting for Taiwan’s Economic Policy toward China*, 13 J. CONTEMP. CHINA 733, 733 (2004) (alteration in original).

¹⁹⁹ 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).

[t]o skirt equity caps, companies have formed international consortiums of several players and phased in major investments over time. Ironic situations can result: As Taiwan's Grace Semiconductor Manufacturing Co. was breaking ground on its new integrated circuit facility in the Pudong district of Shanghai in 2000, legislators in Taipei were still debating whether to ease restrictions on semiconductor investments in the PRC.²⁰⁰

In sum, to avoid the Restrictions, evasive tactics through international channels that Taiwanese firms employ not only turn TDI in China underground but also lead to physical exit of their operation from Taiwan.

We can observe from the illustrations below how underground outward investment in Mainland China becomes. Even in the face of stringent government regulations, TDI in China remained vibrant. Table 2 shows the disparate statistics of TDI in China. Two sets of statistics are shown: one recorded by Taiwan's government and the other by Chinese government, both on a prior approval basis. A large disparity exists between these two statistics. According to Taiwanese statistics, by June 2000 there were a total of 22,475 projects approved to invest in China and a total investment reached \$15,598 million. In the same period 44,915 investment projects were recorded in Chinese statistics while a total amount of investment arrived at \$45,758 million. This suggests that about a half of Taiwanese investment projects did not obtain the prior-approval from Taiwan's government as the law requires. In other words, about half of investments in China by Taiwanese entrepreneurs have evaded Taiwan's Capital Controls. Moreover, a tendency appeared here, showing that even if Taiwan-invested firms did register with Taiwan's government they mostly underreported their investment amounts. For instance, the

²⁰⁰ Karen M. Sutter, *WTO and the Taiwan Strait: New Considerations for Business*, 29 THE CHINA BUS. REV. 28, 29 (2002).

amount of investment registered by Taiwan's government is about one-third of the amount registered by Chinese government. This suggests that the investment amounts that Taiwanese firms reported to their government are also under-stated. 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.²⁰¹ 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."²⁰²

Similar to the above view, Ho and Leng note:

The huge Taiwanese exports to mainland China are driven by the investment activities of Taiwanese business people. However, a huge gap exists between official estimation and real investment value to China. According to official statistics from Taiwan's [MOEA] released in July 2002, the Taiwanese have invested 22.1 billion US dollar in China since 1992. The mainland Chinese authorities estimate that the "negotiated value" of Taiwanese investments has reached US\$59.9 billion. According to Huai-Nan Peng, Chairman of the Central Bank of Taiwan, the accumulated Taiwanese investments to China in the past decade may be around US\$104.5 billion. Peng's estimation reconfirms the huge gap existing between official data and business activities across the Taiwan Straits. In other words, the real economic dynamics across the Taiwan Straits come from autonomous actions from the business community.²⁰³

²⁰¹ Chen & Chu, *supra* note 182, at 218.

²⁰² Jack W. Hou & Kevin H. Zhang, *Taiwan's Outward Investment in Mainland China*, in FINANCIAL MARKETS AND FOREIGN DIRECT INVESTMENT IN GREATER CHINA 182, 186 (Hung-gay Fung & Kevin H. Zhang eds., 2002).

²⁰³ Ho & Leng, *supra* note 198, at 738 (alteration in original) (footnote omitted).

We could thus conclude that “most Taiwanese investments projects on Mainland China are not screened by the Taiwan government,”²⁰⁴ and that “[g]overnmental interventions from Taiwan play only a marginal role in regulating this unique economic relationship.”²⁰⁵ Overall, the rampant evasion might demonstrate high enforcement costs of the Restrictions and their regulatory failure.

1.2.2.2 Regulatory Failure of the Restrictions

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

²⁰⁴ Tse-Kang Leng, *Dynamics of Taiwan-Mainland China Economic Relations: The Role of Private Firms*, 38 ASIAN SURV. 494, 501 (1998).

²⁰⁵ Ho & Leng, *supra* note 198, at 738.

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 would thus decide to organize a company in a third area like the Cayman Islands while owning a controlling interest in that company, or to delegate investment on the Mainland to a company in the same third area.²⁰⁶ Then those companies established or delegated would directly set up a company in Mainland China and transfer capital to that company or have that company list shares in 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 Singapore²⁰⁷), HKSE mostly, so as to raise capital there which the parent company in Taiwan could freely invest in Mainland China.²⁰⁸ Several cases are introduced here to

²⁰⁶ As detailed below in Chapter 3.B.3.1, under the two judgments made by Taiwan's Supreme Administrative Court—Zuigao Xingzheng Fayuan [Sup. Admin. Ct.], 92 Pan Zi No. 1463 (2005) (Taiwan) and Zuigao Xingzheng Fayuan [Sup. Admin. Ct.], 95 Pan Zi No. 1065 (2006) (Taiwan)—the above two routes were held to be in violation of Article 4 of the Regulations.

²⁰⁷ Mainland Affairs Council, The Executive Yuan, The Republic of China (Taiwan), http://www.mac.gov.tw/big5/rpir/2nd7_2.htm (last visited Oct. 8, 2008).

²⁰⁸ During these years, more than 53 Taiwanese companies through these tactics listed on HKSE and 23 on Singapore Stock Exchange. Chin-Ho Hsieh, *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]*, 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], *Tai Min Jin Rong He Zuo Hu Meng Qi Li [The Financial Cooperation between Taiwan and FuJian Province, PRC Benefits Each Other]*, MIN ZHONG RI BAO [THE COMMONS DAILY] (Taiwan), Nov. 4, 2006, www.ettoday.com/2006/11/04/141-2011380.htm (last visited Mar. 23, 2008).

exemplify how these Taiwanese companies find their investment avenues into Mainland China and how Taiwan's judicial authority treats these tactics.

The First case is Taipei Gaodeng Xingzheng Fayuan [Taipei High Admin. Ct.], 95 Su Zi No. 4266 (2006) (Taiwan). In this case, the defendant MOEA argued that the plaintiff United Microelectronics Corporation ("UMC"), founded in 1980 as Taiwan's first semiconductor company and a foundry technology leader and industry leader, by organizing a holding company in BVI (the "Holding Co.") and through a succession of transactions between its subsidiaries, incorporated Hejian Technology (Suzhou) Ltd. ("Hejian") in Mainland China, and that UMC then supplied Hejian with necessary skills and resources to help Hejian smoothly pass through the start-up stage, for which UMC received 15 % of the Holding Co.'s share capital in exchange. MOEA deemed that without its *ex ante* approval, UMC's above conduct was in violation of Paragraph 1 of Article 4 of the Regulations, which stipulates: "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" Consequently, MOEA punished UMC with an administrative fine of NT\$5 million. UMC appealed MOEA's decision to the Taipei High Administrative Court. This court of appeals held for UMC that by relying only on documentation provided by the prosecutor indicting UMC's board chairman and other two executive employees,²⁰⁹ MOEA did not meet its burden of proving that UMC

²⁰⁹ See also Taiwan HsinChu Difang Fayuan [Taiwan HsinChu Dist. Ct.], 95 Zhu Su Zi No. 1 (2006) (Taiwan). In this criminal judgment, the district court held that the three defendants, who were the executive management of UMC, were not guilty owing to lack of evidence that Hejian was given human capital, customer base, management skills and trade secrets by UMC. Taiwan's high-tech industry indicated that this case made salient illegitimacy of the government's re-tightening the Capital Controls announced in the beginning of 2006, as detailed below in Part B.1.2.3 of this chapter. See, e.g., *Lian Dian Sheng Su Zhu*

did make an “investment in the Mainland Area” in violation of Paragraph 1 of Article 4 of the Regulations.

The second case is Taipei Gaodeng Xingzheng Fayuan [Taipei High Admin. Ct.], 95 Su Zi No. 3566 (2006) (Taiwan). In this case, the defendant MOEA argued that the plaintiff An-Hai Ling, a national of Taiwan, by first organizing Cando Investment Limited (“Cando”) in BVI and then through Cando incorporated ARROW in Shanghai, PRC, a company specializing in manufacturing TFT-LCD, and that the plaintiff’s above activities were tantamount to the term “investment in the Mainland Area” in violation of Paragraph 2 of Article 4 of the Regulations, which provides: “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.” In consequence, MOEA punished the plaintiff with an administrative fine of NT\$2 million. The plaintiff appealed MOEA’s decision to the Taipei High Administrative Court. This court of appeals held against MOEA that failing to submit ARROW’s stock ledger or record but merely relying on reports bought from private detective agencies expert in acquiring corporate internal information, MOEA did not meet the burden of proof.²¹⁰

Ke Ye Jie Ren Dui Chan Ye Da Lu Zheng Ce Ju Zhi Biao Zuo Yong [UMC Wins— High Tech Industry Deems It a Leading Case against the Government’s Anti-China-Investment Policy], ZHONG GUANG XIN WEN WANG [BCC NEWS NETWORK] (Taiwan), Oct. 27, 2007, <http://news.msn.com.tw/print.aspx?id=45087> (last visited Oct. 27, 2007). Although the prosecutors appealed this case, Taiwan High Court, the court of appeals, still overruled this appeal and held that the prosecutors met no burden of proof of the defendants’ criminal conduct. See, e.g. Guo-Ren Zhang, *Han Jian An Er Shen Cao Xing Cheng Pan Wu Zui* [UMC’s Former Chairman of the Board Was Found Not Guilty by the Appeals Court], GONG SHANG SHI BAO [INDUSTRY & BUS. TIMES] (Taiwan), Jan. 1, 2009, available at <http://news.chinatimes.com/CMoney/News/News-Page/0,4733,contentx122009010100365,00.html>.

²¹⁰ Also in other two cases, Taipei Gaodeng Xingzheng Fayuan [Taipei High Admin. Ct.], 95 Su Zi No. 1507 (2006) (Taiwan) and Taipei Gaodeng Xingzheng Fayuan [Taipei High Admin. Ct.], 93 Su Zi No. 1063 (2004) (Taiwan), the defendant MOEA could only submit reports bought from these private detective agencies as evidence to show that the plaintiff individual did “invest in the Mainland Area.” As explained

As discussed above, MOEA struggled to enforce the Capital Controls, especially Paragraph 2 of Article 4 of the Regulations. Nonetheless, at least according to these cases, we could find that MOEA often failed to submit documentation with sufficient evidentiary weight, like stock ledgers or records of companies incorporated in a third area such as the Cayman Islands, but punish those allegedly in violation merely by reports bought from private detective agencies expert in acquiring corporate internal information. The courts thus hold 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. Therefore, administrative courts often hold in favor of fleeing corporations which adopt evasive tactics, due to the government's failure to meet the burden of proof to establish "investment in the Mainland Area." This fact also implies that it is not so difficult for Taiwanese companies, especially closely-held corporations usually adopted 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.²¹¹

As a matter of fact, Taiwan's government to an extent cannot help but acknowledge China-investment projects that are already underway via underground channels. As

below, this fact reveals that MOEA, the authority concerned in Taiwanese government's executive branch, lacks the required skills and resources to enforce these restrictions on investing in Mainland China. Apparently, the enforcement cost of the Capital Controls may be too high.

²¹¹ See Cheng-Kai Chou, Fang Kuan Dui Zhong Guo Da Lu Tou Zi Jin E Shang Xian Zheng Ce Zhi Yan Jiu [Research on the Policy of Lifting the Amount Ceiling for China-bound Investment from Taiwan] 123 (Jan. 2008) (unpublished master thesis, Tamkang University) (on file with author) (Taiwan).

shown in Table 3, 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 have illegally invested or entered into technology cooperation in the PRC, during which they can register with MOEA with no or merely a trifling fine.²¹² In March 2008 before the Presidential election, MOEA announced a new round of make-up registration and attracted considerable registrations by substantially lowering administrative fines.²¹³ As these outliers in 1993, 1997, 1998, 2002, 2003, and 2008 demonstrate, on the one hand, Taiwan's government through these "amnesties" intends to make Taiwanese firms' exit to the PRC emerge from underground; on the other hand, Taiwan's government, in a sense, recognizes its regulatory failure of Taiwanese firms' outward investment in Mainland China.

Moreover, since 1991 Taiwan's outward investment has initially been concentrating on countries of the Association of Southeast Asian Nations ("ASEAN"). In 1995 the investment in ASEAN increased to 62.29% of Taiwan's overall outward investment. Afterwards, Taiwan's investment in China increases gradually while the investment in ASEAN decreases year by year. In 1995 the investment in China remains only 17.34% of Taiwan's overall outward investment.²¹⁴ Nevertheless, as shown in Table 4, in April

²¹² 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).

²¹³ *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; the Executive Yuan Will Pardon China-Based Taiwanese Firms]*, FA YUAN FA LÜ XIN WEN [LAWBANK'S L. NEWS] (Taiwan), Mar. 6, 2008, <http://www.lawbank.com.tw/fnews/pnews.php?nid=57870.00> (last visited Mar. 6, 2008).

²¹⁴ TAIWAN JING JI YAN JIU YUAN [TAIWAN INSTITUTE OF ECONOMIC RESEARCH], LIANG AN MAO YI YU

2008 the accumulative total of investment in Mainland China turns out to be the largest proportion of Taiwan's overall outward investment, that is, 55.64%. The second largest goes to British Central America with 16.91%. In fact, British Central America points to tax havens mainly involving BVI and the Cayman Islands. Via these OFCs, Taiwanese firms indirectly make large investment in Mainland China largely in order to evade the Capital Controls imposed from 1997, as further discussed in Part B.2.1.1 of this chapter. Therefore, the real total of investment in Mainland China would exceed 70% of Taiwan's overall outward investment if the percentage of British Central America is added. This fact further illuminates that Taiwan's government possesses poor knowledge of the realities regarding Taiwanese firms' investment in Mainland China,²¹⁵ and that Taiwan's economic regulation hardly could completely stem the outflows of Taiwanese capital and firms. As a matter of fact, Po-Chih Chen, a former chairman of CEPD who helped President Chen's administration to carry through the regulatory transition of relaxation from the NHBP policy to the "Proactive Liberalization with Effective Management" policy (the "PLEM" policy) in 2001, admitted that it was not easy to effectively enforce the Capital Controls given that Taiwanese firms were able to evade this regulation through third countries.²¹⁶ Furthermore, by the time President Chen replaced the NHBP with his own PLEM policy in September 2001, "many had already invested in the

TOU ZI YING XIANG PING GU BAO GAO [ASSESSMENT REPORT ON THE INFLUENCE OF CROSS-STRAIT TRADE AND INVESTMENT] 20-21 (2007) (Taiwan).

²¹⁵ The current Taiwan's SEF Secretary-General Koong-Lian Kao has expressed a similar opinion. See Koong-Lian Kao, *Liang An Jing Mao Zheng He De Qi Dian—Zi You Mao Yi Qu* [The Starting Point of Cross-Straits Economic Integration—Free Trade Area], 2 GUO JIA ZHENG CE LUN TAN [NAT'L POL'Y F.] (ISSUE 7) 26, 31 (2002) (Taiwan); also Xue-Yi Tsai [William Tsai], *Quan Qiu Hua Yu Liang An Jing Ji Fa Zhan* [The Dynamics and Analyses of Direct Trading Relationships between Taiwan and China], 2 ZHAN WANG YU TAN SUO [PROSPECT & EXPLORATION] 34, 43 (2004) (Taiwan).

²¹⁶ Po-Chih Chen, *Dui Zhong Guo Da Lu Tou Zi De Zheng Ti Ce Lue* [The Integral Strategy of Investment in Mainland China], 25 TAIWAN JING JI YAN JIU YUE KAN [TAIWAN ECON. RES. MONTHLY] (ISSUE 4) 137, 141 (2002) (Taiwan).

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.”²¹⁷

To put it in a nutshell, the huge gap between Taiwan’s official estimation and Taiwanese firms’ real investment value to China, on the one hand, reveals that costs of enforcing the Capital Controls are so high that ineffective enforcement results. This, on the other hand, emphasizes that Taiwan’s regulatory failure is a consequence of Taiwanese firms’ internationalization.²¹⁸ In particular, the pivotal lesson we can learn is concerned with the changing role of nation states. The above discussion illustrates that even if Taiwan has the intention to enforce the Capital Controls as effectively as possible, it is endowed with little capability for such enforcement. Therefore, despite the strictness of the Capital Controls, Taiwan’s government possesses few required resources and skills to implement the regulations, which highlights Taiwan’s predicament that laws alone cannot carry themselves into practice. For instance, although the huge gap existing between Taiwan’s official data and business activities across the Strait clearly evidences that many Taiwanese firms circumvent the Capital Controls, MOEA and other authorities concerned scarcely succeed in meeting their burden of proof to punish these illegal activities. That way, the regulatory authority of Taiwan’s government suffers many a setback. Since Taiwanese firms progressively change into MNCs with the ability of international planning and management, the Taiwanese government’s substantial

²¹⁷ Ho & Leng, *supra* note 198, at 737-38 (alteration in original).

²¹⁸ See Leng, *supra* note 180, at 34.

intervention in market mechanisms of cross-Strait economic interaction naturally brings about the salient gap between private activities and government policies.²¹⁹

Coming up against the Capital Controls and Constraints, Taiwanese companies with mass investment in Mainland China would thus be unwilling to raise capital in Taiwan stock markets. Indeed, they need a huge amount of capital to meet financial demand of their subsidiaries or affiliates in Mainland China. Therefore, they cannot but through the following similar tactics list their shares in other stock markets in the Greater Chinese Economy, HKSE among others, so as to take the “exit” option to evade the Restrictions.

1.3 Common Evasive Tactics to List Shares Overseas

As Deng reports, “the total amount of Taiwanese capital flowing into China remains difficult to estimate. . . . By 1998, the amount of Taiwanese investment approved by China had reached a formidable \$41.11 billion going to 41,455 projects. In monetary value, Taiwanese investment in China ranked second after Hong Kong at that time.”²²⁰ What’s more important is that “investment in China has shifted from labor-intensive, low value-added and short-term operations to more capital- and technology-intensive industries with longer investment horizons such as computers, construction equipment, machinery, and petrochemicals.”²²¹ For instance, Taiwan’s biggest manufacturer of personal computers (“PC”), Acer Computer, Inc. (“Acer Computers”),²²² “has begun to

²¹⁹ See *id.* at 37.

²²⁰ Deng, *supra* note 174, at 962.

²²¹ *Id.* at 963

²²² Founded in 1976, Acer Computers ranks as the world's third-largest company for total PC shipments, is No. 2 for notebooks, and has a global workforce of more than 6,000 employees. See Acer Group, http://www.acer-group.com/public/The_Group/overview.htm (last visited May 19, 2009).

manufacture a large number of advanced color monitors in China and half of its capital is valued as technology transfer.”²²³ This example means that regardless of Chinese military intimidation, Taiwan’s Information Technology (“IT”) firms, “over the past two decades, have continued to sail across the strait for cheaper land and labor.”²²⁴ Specifically, in order to enlarge their business or acquire necessary natural and labor resources in Mainland China, many Taiwanese companies that have listed in Taiwan stock markets might usually, through companies incorporated in a third area such as the Cayman Islands, invest in Mainland China indirectly. For fear of being subject to the Restrictions while avoiding MOEA’s oversight, most of these listed companies might through spin-offs split their China-based business into another company incorporated in some OFC, and subsequently have that company list shares in other neighboring stock markets, not least HKSE.²²⁵ In this case, Taiwan lost many excellent companies which could have listed in Taiwan stock markets. Meanwhile Taiwan should have not lost relevant business, such as financial services, if these companies had maintained their head offices at home. This common type of evasive tactics may be regarded as a physical exit by many China-based Taiwanese companies.

For example, take Hon Hai Precision Industry Company Limited (“Hon Hai”), a renowned high-tech company incorporated in Taiwan, to elaborate on a type of these large companies’ similar routes into Mainland China. According to Global Offering Prospectus of Foxconn International Holdings Limited (the “Prospectus”), Hon Hai is “a

²²³ Deng, *supra* note 174, at 964.

²²⁴ Yang & Hung, *supra* note 199, at 681-82.

²²⁵ Ming-Hsuan Lin, Tai Shang Qi Ye Zhi Xiang Gang Shang Shi Zhi Xing Tai Mo Shi Fen Xi [The Model Analysis of Listing Types in Hong Kong for Taiwan Enterprise] 94-95 (June 2007) (unpublished master thesis, TamKang University) (on file with author) (Taiwan).

company incorporated on February 20, [1974] under the laws of Taiwan and listed on Taiwan Stock Exchange,”²²⁶ and has “a consolidated turnover of over \$11 billion in 2003.”²²⁷ Since Hon Hai’s formation, it together with its subsidiaries (the “Hon Hai Group”), including the main actor in this story — Foxconn International Holdings Limited (“FIH”),

has become one of the largest global manufacturing services providers in the computer, communications and consumer electronics industries. The Hon Hai Group designs, manufactures and markets connectors and cable assemblies in the computer and computer peripherals, communications and consumer electronics industries. It engages in the design, manufacture and marketing of enclosures, principally for personal computers. Within the Hon Hai Group, [FIH] has specialized in manufacturing handsets.²²⁸

Nevertheless, the Hon Hai Group effectuated the “Restructuring” in early 2004. Subsequent to the Restructuring, FIH, having become an independent stand-alone company, owns 100% of the business of handset manufacturing services, which is mainly based in Mainland China but previously owned by Hon Hai. That is, since the Restructuring, FIH has separated its production and management from that of Hon Hai while developing client relationships independently of Hon Hai.²²⁹

Moreover, the majority of FIH’s assets are located in the PRC, Hungary and Mexico while only a handful of its remaining assets are located in Taiwan.²³⁰ In other words, before FIH was spun off from Hon Hai, Hon Hai had had a need to freely shift funds

²²⁶ GLOBAL OFFERING PROSPECTUS OF FOXCONN INTERNATIONAL HOLDINGS LIMITED 15 (Jan. 24, 2005), <http://main.ednews.hk/listedco/listconews/sehk/20050124/LTN20050124000.htm> (alteration in original).

²²⁷ *Id.* at 2.

²²⁸ *Id.* at 93 (alteration in original).

²²⁹ *Id.*

²³⁰ *Id.* at 10, 41.

raised in Taiwan stock markets in order to satisfy FIH's financial demand in Mainland China but was not permitted so under the Constraints. Furthermore, it was not feasible for Hon Hai's overseas subsidiaries based in Mainland China to list their shares in Taiwan stock markets due to the Constraints. Therefore, for the expansion of the capacity of FIH's existing production facilities in Mainland China, Hon Hai cannot but opt, through a succession of transactions between its subsidiaries incorporated in the Cayman Islands, to incorporate FIH at the same place, to which Hon Hai transferred relevant production, management and clients with respect to the handset business while indirectly owning a controlling interest in FIH. Then FIH established its head office in Shenzhen, Guangdong, PRC²³¹ and headed for HKSE to raise capital which could freely be utilized in Mainland China. As commentators maintain, all of Hon Hai's tactics are arguably to evade Taiwan's Capital Controls and Constraints.²³² This, nonetheless, results in the physical exit of Hon Hai's *nearly entire* handset business from Taiwan. Accordingly, even if many China-based Taiwanese companies desire to keep their head offices in Taiwan while expanding their business in Mainland China, the Restrictions apparently discourage them from doing so. At the very least, a Taiwanese corporate group could, though, avoid the Capital Controls and Constraints by possessing an independent subsidiary incorporated offshore with the ability to freely raise funds overseas to satisfy financial need of expansion or operation in China.

²³¹ *Id.* at 58.

²³² See e.g., Lin, *supra* note 225, at 95; Chou, *supra* note 211, at 118; Jerry G. Fong, *Chu Zou Taiwan Yuan Li Mei Guo—Cong Ri Yue Guang An Kan Tai Shang Chu Zou Chao [Exiting from Taiwan and Leaving the United States: On Trends of Taiwanese Firms' Exit in Light of the Incident of ASE Group]*, 611 NENGLI ZAZHI [LEARNING & DEV.] 96, 99-100 (2007) (Taiwan); Zhao-Ming Wu, *Tai Zi Qi Ye Yu Da Lu Ji Xiang Gang Shang Shi De Yan Jiu—Yi Xiang Guan Ge An Yan Jiu Wei Li [The Study of Public Listing on the China and Hong Kong Stock Exchanges for Taiwan-Based Companies—Related Case Study]* 101 (July 2006) (unpublished master thesis, National Chengchi University) (on file with author) (Taiwan).

Once waves of large Taiwanese companies list their shares on HKSE, the proportion of these issuers' aggregate value to that of all listed firms on HKSE will thus increase. What follows is that international investors would appreciate more and more highly the stocks of these Taiwan-invested firms which are incorporated in OFCs and based in China. For instance, investors started to classify China-based Taiwanese businesses listed on HKSE as "T-Share." If T-Share group becomes bigger and bigger, international investors intending to share China's economic development will buy these T-Shares. In Hon Hai's case, Hon-Hai spun off its handset business, which is one of its core competencies, into FIH, and had FIH list shares on HKSE. Since FIH is growing faster than Hon-Hai, foreign investors may purchase more FIH shares than those of Hon-Hai on Taiwan Stock Exchange ("TWSE") instead. Because Hon Hai's shares are TWSE's value-weighted stocks, if Hon Hai's stock price declines accordingly, TWSE stock index may be forced to run down as well. Supposing that more and more large Taiwanese listed companies, under the cluster effect, would through tactics similar to Hon Hai's Restructuring have their China-based overseas subsidiaries listed on HKSE, because the stock price of Taiwanese parent companies might fall, the outlook of the TWSE stock index would also be gloomy.²³³

2. The Supply Side of the Law Market

2.1 Mainly Selling Legal Flexibility, Rather than Legal Bonding

²³³ See Chia-Chen Lee, *Tai Zi Qi Ye Zai Xiang Gang Shang Shi Wen Ti Zhi Yan Xi* [A Study on the Issue of Taiwanese Enterprises Listing in Hong Kong], 8 JING JI YAN JIU [ECON. RES.] 357, 371-73 (2008) (Taiwan).

As discussed above, substantial evidence supports the bonding explanation of cross-listing. Under this dominant explanation, cross-listing firms are seeking stronger laws.²³⁴ To name a few, John Coffee presents the thesis that “although the cross-listing decision involves a complex interaction of bonding, signaling, self-selection, and reduced informational asymmetry, the overall evidence supports the ‘bonding hypothesis’ and suggests that U.S.’s greater emphasis on enforcement reduces informational asymmetry and gives it a lower cost of equity capital.”²³⁵ He also asserts that “one legal variable—the level of enforcement—does distinguish jurisdictions in a manner that can explain national differences in the cost of capital (especially between common law and civil law countries)”²³⁶ Nonetheless, in Taiwan’s case, it seems that China-based Taiwanese businesses spurn exchanges at home and choose to go public in other neighboring stock markets, especially HKSE, not mainly to opt into the laws thereof and to bond their insiders given the “bonding” hypothesis, but rather to “avoid” the Restrictions.

As shown in Table 5²³⁷, JP Morgan has made an assessment of listing merits among TWSE, HKSE, and the U.S. stock exchanges in 13 indices. Some may think this report appears to support a bonding hypothesis that Taiwanese firms flock to list on HKSE just because Investor Protection of HKSE is better than that of TWSE where Investor Protection in the former is evaluated as high whereas the latter is medium. Nevertheless,

²³⁴ Ribstein, *supra* note 51, at 104.

²³⁵ John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement* 3 (Columbia Law & Econ. Working. Paper No. 304, 2007), available at <http://ssrn.com/abstract=967482>.

²³⁶ *Id.* at 6.

²³⁷ Table 5 is cited from: SHI JIE ZONG HE YAN JIU ZHONG XIN GU FEN YOU XIAN GONG SI [ACCUMIND RESEARCH, INC.], CONG TAI SHANG HAI WAI SHANG SHI KAN TAIWAN ZI BEN SHI CHANG GUO JI HUA ZHUAN TI YAN JIU BAO GAO [THE PROJECT REPORT ON THE INTERNALIZATION OF TAIWAN’S CAPITAL MARKETS IN LIGHT OF LISTING OVERSEAS BY TAIWANESE FIRMS] 28 (2007) [hereinafter *Internationalization*] (Taiwan).

the differences between TWSE and HKSE do not appear to be that large: When it comes to the U.S., Listing Requirements and Disclosure Requirements are both “strict” while Investor Protection, Listing Cost and Expenditure, and Visibility in International Markets are “high.” Compared with the U.S., both TWSE and HKSE are inferior in a similar manner.²³⁸

As Litvak notes, “cross-listing has important costs (compliance with stricter governance and accounting rules; exposure to the threat of shareholder litigation, which is common in the United States and rare elsewhere, and so on).”²³⁹ In comparing listing costs among TWSE, HKSE, the Singapore Stock Exchange and China’s two stock markets, a famous senior partner in Taiwan’s branch of KPMG (one of the top four global accounting firms) has said that the listing cost in Taiwan, including listing fees, underwriting fees, tax, attorney fees, accountant fees and time cost, is the lowest.²⁴⁰ Another research paper indicates that the listing cost of HKSE is four or five times that of TWSE.²⁴¹

The fact that Taiwanese firms listed in Hong Kong despite higher costs, and surged to list back in Taiwan after the Capital Controls were considerably lightened in 2008 as discussed below in Part A.2.3 of this chapter indicates that the securities regulation in

²³⁸ *Id.* at 27.

²³⁹ Litvak, *supra* note 131, at 1862.

²⁴⁰ SONG-QI TSAI [EDWARD TSAI], SHANG SHI GUI ZHI TONG CHE: LIANG AN SAN DI JI XIN JIA PO SHANG SHI SHI YONG ZHI NAN [A THROUGH TRAIN TO GO PUBLIC: PRACTICE GUIDELINES FOR LISTING IN CHINA, HONG KONG, TAIWAN OR SINGAPORE] 264-65 (2008) (Taiwan). *See also* Chia-Chen Lee, *Tai Zi Qi Ye Zai Da Lu Shang Shi Wen Ti Zhi Tan Tao* [A Study on the Problems of Stock Market Listing by Taiwan-Invested Firms in Mainland China], 4 JING JI YAN JIU [ECON. RES.] 157, 173-74 (2003) (Taiwan); Li-Jun Hong, *Tai Zi Qi Ye Zai Da Lu Zheng Quan Shi Chang Fa Xing Shang Shi Zhi Tan Tao* [The Research on Listing in China’s Stock Markets by Taiwanese Firms] 164 (June 2007) (unpublished LL.M. thesis, National University of Kaohsiung) (on file with author) (Taiwan); *Internationalization*, *supra* note 237, at 74.

²⁴¹ Lee, *supra* note 233, at 364.

Hong Kong might not be meaningfully stricter or otherwise significantly different (except for the Capital Controls)²⁴² than that in Taiwan when Taiwanese firms considered listing shares in Taiwan or Hong Kong prior to the relaxation in 2008. In concrete terms, according to Deloitte Touche Tohmatsu in Taiwan (one of the top four global accounting firms), since the relaxation of the Capital Controls occurring in the second half of 2008 through October 9, 2009, a record 34 Taiwan-invested offshore corporations have initiated or completed the procedures to list shares back in Taiwan. Among them, 29 firms intend to apply for doing IPOs (they would be Primary Listing Issuers).²⁴³ From the relaxation in question until November 13, 2009, 10 Taiwanese offshore firms mostly listed in Hong Kong have applied for listing TDRs (they would be Secondary Listing Issuers); most of them are China-based.²⁴⁴ Among them, Taiwan Ting Hsing Group (whose Master Kang-brand instant noodles have been a great success in China) is the largest food and drinks manufacturer in the Greater Chinese Economy. It has had its overseas holding company, Tingyi (Cayman Islands) Holding Corp., list shares in

²⁴² See Tai-San Ciou & Jung-Pao Kang, *Hai Wai Tai Shang Ru He Zai Taiwan Shang Shi Gui?* [*How Do Overseas Taiwanese Firms List Shares in Taiwan?*], 349 GUAN LI ZA ZHI [MGMT. MAG.] 54, 54-55 (2003) (Taiwan) (arguing that compared with other stock exchanges in China, Hong Kong, Singapore, and Malaysia, Taiwan stock markets would be Taiwanese firms' best option for listing shares if the Capital Controls and Constraints could be further liberalized in the future).

²⁴³ Xin-Ren Wang, *Qin Ye Qian Zheng Tai Shang Hui Tai Shang Shi Ju Di Yi* [*Deloitte Stays Top in Granting Certification to Taiwanese Firms Listing Shares Back in Taiwan*], GONG SHANG SHI BAO [INDUSTRY & BUS. TIMES] (Taiwan), Oct. 9, 2009, available at <http://news.chinatimes.com/CMoney/News/News-Page-content/0,4993,11050709+122009100900351,00.html>.

²⁴⁴ Jia-Qi Zhang, *Tai Shang Sheng Ma Ding Shen Qing Fan Tai Fa Xing TDR* [*Sandmartin Applies for Listing TDRs Back in Taiwan*], ZHONG GUANG XIN WEN WANG [BCC NEWS NETWORK] (Taiwan), Oct. 31, 2009, available at <http://news.chinatimes.com/CMoney/News/News-Page-content/0,4993,130508+132009103100566,00.html>; Shu-Yi Wang, *Kang Shi Fu Shen Qing Hui Tai Fa Xing TDR* [*Master Kang Applies for Listing TDRs Back in Taiwan*], ZHONG SHI DIAN ZI BAO [CHINA TIMES DAILY NEWS] (Taiwan), Nov. 3, 2009, available at <http://news.chinatimes.com/CMoney/News/News-Page-content/0,4993,130508+132009110300646,00.html>; Rui-Yi Zhang & Jing-Wen Zhang, *Qi Jing Quang Dian Shen Qing Di Yi Shang Shi* [*Himax Technologies, Inc. Applies for Primary Listing*], GONG SHANG SHI BAO [INDUSTRY & BUS. TIMES] (Taiwan), Nov. 13, 2009, available at <http://news.chinatimes.com/CMoney/News/News-Page-content/0,4993,11050802+122009111300356,00.html>.

Hong Kong since 1996 and has so far become the Taiwan-invested HKSE-listed company with the largest market value and profitability. It made an application for listing its TDR on TWSE on November 2, 2009²⁴⁵ and has already listed TDRs on December 16, 2009.²⁴⁶ In addition, no major amendment to Taiwan's securities laws has been made in this post-relaxation period. Since the bonding effect provided by Taiwan stock markets stays constant, as Taiwanese investment banks²⁴⁷, TWSE²⁴⁸, Investment Commission of MOEA²⁴⁹ argue, the moderation of the Capital Controls, to a great extent, contributes to the current craze of offshore Taiwanese firms listing back in Taiwan.²⁵⁰ In other words, the remarkable rise in the listing-back rate up to now likely reflects the relaxation of the

²⁴⁵ Tingyi (Cayman Islands) Holding Corp., *Filing of the Application for the Listing of Taiwan Depositary Receipts* (Nov. 2009), <http://www.masterkong.com.cn/InvestorInformationen/Circulars/> (last visited Nov. 10, 2009); Jia-Qi Zhang, *Kang Shi Fu Fan Tai Fa TDR Shi Pin Qu Jiao Hao* [Master Kang Went Home to List TDRs, Food Stocks Rally], ZHONG GUANG XIN WEN WANG [BCC NEWS NETWORK] (Taiwan), Nov. 3, 2009, available at

<http://news.chinatimes.com/CMoney/News/News-Page-content/0,4993,130508+132009110300885,00.html>.

²⁴⁶ Xiu-Yun Cao, *Kang Shi Fu TDR Shi Er Yue Shi Qi Ri Gua Pai* [Master Kang TDRs Will Be Listed on December 17], ZHONG GUO SHI BAO [CHINA TIMES] (Taiwan), Nov. 18, 2009, available at <http://news.chinatimes.com/CMoney/News/News-Page-content/0,4993,11050802+112009111800387,00.html>.

²⁴⁷ Zong-Tong Wang & Zong-Zhi Liu, *Gui Yu Fan Xiang TDR Re Tai Gang Shi Chang Da Fan Pan* [Listing TDRs Back in Taiwan like the Return of Spawning Salmon, The Game Has Been Changed between Taiwan and Hong Kong Stock Markets], ZHONG GUO SHI BAO [CHINA TIMES] (Taiwan), Oct. 12, 2009, available at

<http://news.chinatimes.com/CMoney/News/News-Page-content/0,4993,11050802+112009101200151,00.html>;

Zong-Tong Wang, *Liang An Hong Li Tai Gu Jiang Cheng Ya Tai "Na Si Da Ke"* [The Restrictions on Cross-Strait Exchange Have Been Relaxed, TWSE Would Become the Asia Pacific "NASDAQ,"], ZHONG GUO SHI BAO [CHINA TIMES] (Taiwan), Oct. 12, 2009, available at

<http://news.chinatimes.com/CMoney/News/News-Page-content/0,4993,11050802+112009101200152,00.html>.

²⁴⁸ Zong-Zhi Liu, *Tai Shang Hui Tai Shang Shi Ma Zheng Fu Ji Ji Tui Dong* [The Ma Administration Aggressively Attracts Taiwanese Firms to List Shares Back in Taiwan], ZHONG GUO SHI BAO [CHINA TIMES] (Taiwan), Apr. 16, 2009, at A5; Jia-Qi Zhang, *Wang Wang TDR Xiao Ying Si Yue Fen You San Jia Tai Shang Shen Qing Fan Tai Gua Pai* [The Effect of Want Want China's TDR: 3 Taiwanese Firms Apply for Listing Shares Back in Taiwan this April], ZHONG GUANG XIN WEN WANG [BCC NEWS NETWORK] (Taiwan), May. 1, 2009, available at

<http://news.chinatimes.com/CMoney/News/News-Page-content/0,4993,130508+132009050100851,00.html>.

²⁴⁹ Song Bang Deng Lu Shang Xian Liu Shi Er Jia Tai Shang Ni Hui Tai Shang Shi Gui [The Upper Limits on Investment in Mainland China Are Relaxed, 62 Taiwanese Firms Plan to List Shares Back in Taiwan], TAIWAN XIN SHENG BAO [TSSDNEWS] (Taiwan), Feb. 5, 2009, at 2.

²⁵⁰ See also *Tai Shang Fan Xiang Gua Pai Shang Ji Wu Xian* [Taiwanese Firms' Listing Back in Taiwan Brings Much Business], DA LU TAI SHANG 1000 DA: TAI SHANG JIN HUA LUN [TOP 1000 CHINA-BASED TAIWANESE FIRMS: THE EVOLUTIONISM OF TAIWANESE FIRMS], June 12, 2009, at 153-55 (Taiwan).

Capital Controls which previously had left listing shares in Taiwan a worse choice than in Hong Kong. This fact indirectly evidences that the quality of the mandatory disclosure law and enforcement regime of the Hong Kong stock market neither is significantly better than those of Taiwan stock markets nor matters in the competition for cross-listing business, and that when Taiwanese firms considered listing shares in Taiwan or Hong Kong before the relaxation in 2008, the determinant affecting their decisions would likely be primarily to avoid the Capital Controls, rather than to bond their insiders. Therefore, it's difficult to jump to the conclusion that China-based Taiwanese firms spurn stock exchanges at home and choose to go public in other neighboring stock markets, especially HKSE, mainly in order to opt into the laws thereof and to bond their insiders according to the bonding hypothesis.

What's more, according to Taiwanese scholars' empirical studies explicated below, the trend that many Taiwanese firms list shares on HKSE during recent years can be primarily attributed to the fact that they cannot but avoid the Capital Controls and Constraints and then buy regulatory products of legal flexibility which HKSE and other stock markets in the Greater Chinese Economy can sell. In this case, they would rather trade the higher costs of listing incurred in the short term for the legal flexibility to use funds raised in neighboring stock markets, which would offer the long-term reward of investment in Mainland China. In other words, it is more likely the Capital Controls, rather than legal bonding, that drove the choice of Hong Kong or Taiwan listing markets prior to the relaxation in 2008 as discussed below.

In a case study on Mayer Steel Pipe Corporation (“Taiwan Mayer”), the General Manager of Taiwan Mayer was interviewed for reasons why it followed a pattern similar to Hon Hai’s Restructuring to have its Mainland subsidiary, Mayer Holdings, list shares on HKSE. To begin with, Taiwan Mayer is the first specialized manufacturer of steel pipes and tubular products in Taiwan. Since its founding in 1959, Taiwan Mayer has been devoted to the production and selling of high-quality steel pipes and tubes and has also built up a powerful distribution network to ensure its market share leadership. In April 1993, Taiwan Mayer went public on TWSE. In 1997, Taiwan Mayer, through a succession of offshore transactions, established Guangzhou Mayer in Mainland China. Guangzhou Mayer has received wide recognition and support from clients, with its products already reaching Eastern and Central China markets with great success. On October 9, 2003, Taiwan Mayer incorporated Mayer Holdings in the Cayman Islands to hold a majority of shares of Guangzhou Mayer. On June 21, 2004, Mayer Holdings went public on HKSE.²⁵¹ Taiwan Mayer’s General Manager suggested that factors such as legal bonding cannot be responsible for the key underlying reason that Mayer Holdings listed shares on HKSE. He indicated that the primary cause for Mayer Holdings to list on HKSE was to find a stock market where they can use raised capital without being subject to the Restrictions.²⁵² He added that even though Mayer Holdings was listed on HKSE, they were still unfamiliar with Hong Kong law and regulations, and that if Taiwan’s government had not imposed the Capital Controls and Constraints, Taiwan Mayer would

²⁵¹ See Mayer Steel Pipe Corporation, <http://www.mayer.com.tw/about/about-english.htm> (last visited May 20, 2009); Cui-Huang Weng, *Tai Shang Zai Xiang Gang Shang Shi Yu Hui Tai Shang Shi Wen Ti Zhi Tan Tao* [The Discussion on Issues of Taiwanese Enterprises’ Listing Shares in Hong Kong and Back in Taiwan] 79-80 (Jan. 2006) (unpublished master thesis, National Chengchi University) (on file with author) (Taiwan).

²⁵² *Id.* at 86-87.

not have had Mayer Holdings list shares overseas.²⁵³ This case study led to a conclusion that the principal cause for Taiwanese listed companies to have their Mainland subsidiaries or affiliates list share overseas, rather than in Taiwan, was the Capital Controls and Constraints.²⁵⁴ This conclusion was also confirmed by a study conducting in-depth interviews with TWSE, a leading Taiwanese investment bank's branch in Hong Kong, the Taiwanese branch of Ernst & Young (one of the top four global accounting firms), and five Taiwan-invested firms which either listed shares in Taiwan, Hong Kong or Mainland China, or were considering where to go public.²⁵⁵

²⁵³ *Id.* at 89.

²⁵⁴ *Id.* at 97.

²⁵⁵ Shu-Min Li, *Tai Shang Hui Tai Shang Shi Wen Ti Ji Jie Jue Fang An Zhi Tan Tao* [The Analysis of Initial Public Offering Problems and Solutions of Returning Taiwan to Listing Security for Taiwan Overseas Companies] 78-79, 91-92 (Dec. 2004) (unpublished master thesis, National Chung Hsing University) (on file with author) (Taiwan). Not a few commentators come to similar conclusions as well. *See, e.g.*, Sen-Ying Qiu, *Da Lu Tai Shang Hui Tai Shang Shi Gui Huan Jing Zhi Yan Jiu* [The Analysis of the Environment for Listing Shares Back in Taiwan by China-Based Taiwanese Firms] 71 (May 2003) (unpublished master thesis, National Taiwan University of Science and Technology) (on file with author) (Taiwan); Yu-Chen Ling, *Wai Guo Qi Ye Lai Tai Shang Shi Gui Wen Ti Zhi Yan Xi* [A Study on the Problems of Public Listing by Foreign Enterprises in Taiwan], 4 *JING JI YAN JIU* [ECON. RES.] 135, 145, 149-50 (2003) (Taiwan); Hornng-Ming Tsai, *Da Lu Zheng Quan Shi Chang Fa Zhan Dui Liang An Jing Mao Zhi Ying Xiang* [The Impact of the PRC's Stock Market Developments on Cross-Strait Economic Interactions], 5 *ZHAN WANG YU TAN SUO* [PROSPECT & EXPLORATION] (ISSUE 1) 54, 68 (2007) (Taiwan); Town-Shine Wu, *Taiwan Qi Ye Hai Wai Chou Zi Zhi Yan Jiu—Jian Lun Hai Wai Taiwan Qi Ye* [A Study on Overseas Fundraising by Taiwanese Enterprises: With Discussion on Fundraising by Overseas Taiwanese Enterprises in Taiwan] 67-68, 114, 120 (July 2008) (unpublished master thesis, National Taiwan University) (on file with author) (Taiwan); Wu, *supra* note 232, at 100-01; Yong-Kang Wang, *Da Lu Tai Shang Qi Ye Shang Shi Jue Ce Yin Su Fen Xi—Ge An Zhe Jiang Guo Xiang Zhi Leng Gong Ye Gu Fen You Xian Gong Si* [The Analysis of Factors for Decision-Making in IPOs by China-Based Taiwanese Firms—A Case Study on Zhejiang King Refrigeration Industry Co., Ltd], at 2 (of Chapter 5) (Jan. 2004) (unpublished master thesis, National Chengchi University) (on file with author) (Taiwan); YA-HUI YANG & XIAO-TIAN LONG, *ZI BEN SHI CHANG FA ZHAN YU TAIWAN QI YE CHOU ZI ZHI FEN XI* [THE ANALYSIS OF THE DEVELOPMENT OF CAPITAL MARKETS AND TAIWANESE FIRMS' FINANCING] 60 (2004) (on file with author) (Taiwan); Zai-Dong Zhao, *Tai Shang Qi Ye Zai Da Lu Shang Shi Zhi Ke Xing Xing Yan Jiu* [The Feasibility Study of Entering China Stock Markets for Taiwanese Enterprises] 49, 71 (June 2006) (unpublished master thesis, National Taiwan University of Science and Technology) (on file with author) (Taiwan); Chou, *supra* note 211, at 107-08; Hong-Yuan Chang, *Tai Shang Fu Gang Shang Shi Yu Qi Ke Neng Zhi Ying Xiang* [The Influence on Taiwan Enterprise IPO in Hongkong Stock Market], 5 *ZHAN WANG YU TAN SUO* [PROSPECT & EXPLORATION] (ISSUE 12) 11, 11 (2007) (Taiwan); Research Department, Supervision of Markets Division, The Securities and Futures Commission, *Hong Kong Consolidates its Role as a Fund-raising Platform for the Greater China Region with Increased Listing of Taiwanese Companies* 5 (May 2008), www.sfc.hk/sfc/doc/EN/research/research/RS%20Paper%2040.pdf (hereinafter *Platform*) (last visited Dec. 1, 2009) (H.K.); CHU-CHIA LIN, *CHONG HUI JING JI GAO DIAN: LIANG AN JING MAO YU TAIWAN WEI LAI*

Moreover, from July 2006 to January 2007, a research team led by I-Ru Liu, a former legislator in Taiwan and also an adjunct professor of finance in National Taiwan University, (“I-Ru Liu Team”) made research into the reasons for Taiwanese companies to list shares overseas. They held three large conferences with scholars, industries, government officials and professionals. They surveyed Taiwanese companies and investment banks by questionnaires. They also extensively interviewed a foreign investment bank and a domestic one respectively, both of which have experiences to guide and counsel listing shares overseas by Taiwanese companies. Although there are other reasons for Taiwanese companies to list overseas, the team concludes that the policy and direct reason is that the Capital Controls and Constraints compel Taiwan-invested companies to list overseas. Specifically, China-based Taiwanese businesses wish to expand their markets in Mainland China. If they list shares in Taiwan stock markets, the capital raised cannot be used freely for investments in China. Encountering the Capitals Control and Constraints, they are forced to avoid the regulation and list shares overseas. For these Taiwanese firms with large investment needs in Mainland China, HKSE provides them with a capital-raising venue where they can at liberty use the capital raised to invest in China.²⁵⁶ To put it in another way, Taiwan stock

[COMING BACK TO AN ECONOMIC CLIMAX: CROSS-STRAIT ECONOMIC RELATIONS AND THE FUTURE OF TAIWAN] 148 (2008) (Taiwan) (arguing that the Capital Controls and Constraints have driven Taiwanese firms with heavy investment in China to be listed on HKSE even if listing costs are higher in Hong Kong than in Taiwan, in the sense that the capital raised in Taiwan cannot be freely used for investments in China due to the Restrictions).

²⁵⁶ *Internationalization*, *supra* note 237, at 85-86. Many other commentators also arrive at the same conclusion. See, e.g., Ya-Hui Yang, *Gong Si Shang Shi Gui Ying Xiang Yin Su Yu Guo Ji Ban Yuan Jing* [Factors Affecting Firms' Listing and the Vision for International Listings], 34 QUAN QIU TAI SHANG E JIAO DIAN [THE E-FOCUS OF GLOBAL TAIWANESE FIRMS] (Sep. 6, 2005), <http://twbusiness.nat.gov.tw/>; JUNG-PAO KANG, TAI SHANG QI YE JIU DI SHANG SHI YIN YING CE LÜE ZHI YAN JIU [THE RESEARCH ON RESPONSIVE STRATEGIES OF LOCAL LISTINGS BY TAIWANESE FIRMS] 160-61(2003) (on file with author) (Taiwan); Tsai, *supra* note 240, at 237, 274; I-Ming Chang, *Da Lu Tai Shang Yu Guo Nei Shang Shi* (Gui) *Ke Xing Xing Yan Jiu— Yi Taiwan Zi Ben Shi Chang Wei Li* [The Study of Taiwanese Enterprises in Mainland China

markets should have been China-based Taiwanese firms' best listing option to raise funds for investments in China. But due to the Capital Controls and Constraints, HKSE turns out to be the second best choice in the sense that it provides a listing product of legal flexibility for investing raised funds in any purpose as Taiwanese firms themselves see fit.²⁵⁷

Furthermore, there exists another study to interview two Taiwanese companies having been listed in TWSE. Both of them build plants in China mainly in order to lower manufacturing costs and cultivate huge local consumer markets. They both, through evasive tactics like the Restructuring of Hon Hai, have their subsidiaries list on HKSE. Their decisions are based on the ground that expansion in production in China requires more funds but parent companies in Taiwan are subject to the Capital Controls and Constraints so that they have no other choice but to list shares on such a neighboring stock exchange as HKSE to raise necessary funds.²⁵⁸

Launching IPO at Taiwan Securities Market] 93, 95-96 (June 2004) (unpublished master thesis, National Chiao Tung University) (on file with author) (Taiwan); Lee, *supra* note 233, at 376; Chun Min Huang, Taiwan Yu Xiang Gang Zi Ben Shi Chang Zhi Jing Zheng Tai Shi—Jian Lun Cheng Xiao Shou Xu Fei Zhi Cha Yi [To Evaluate the Competition between Taiwan and Hong Kong Capital Market and Follow Up the Comparison of the Management Fee] 59, 63 (June 2007) (unpublished master thesis, National Sun Yat-sen University) (on file with author) (Taiwan); Fong, *supra* note 232, at 98-99; Jung-Pao Kang, *Liang An San Di Zai Na Li IPO?* [Where to do IPOs among Cross Tri-Regional Securities Markets], 362 GUAN LI ZA ZHI [MGMT. MAG.] 30, 34 (2004) (Taiwan); Lin, *supra* note 225, at 8, 89; Xiupo Wu, *Zhong Guo Wang Wang Wei He Cong Xin Jia Po Dao Xiang Gang Shi Chang Shang Shi ?* [Why Did Want Want China Choose to Be Listed in Hong Kong Instead of Singapore?], GUO JI RONG ZI [INT'L FINANCING], June 2008, at 45 (P.R.C.); Jianhua Wang, *Xian Zhi Tai Duo Zheng Ju Bu Wen Xin Xin Bu Zu Tai Shang Bei Po Fu Gang Shang Shi* [Too Many Restrictions, Unstable Politics and Lack of Confidence Forced Taiwanese Businesses to Be Listed in Hong Kong], TAI SHENG [VOICE OF TAIWAN], Sep. 2004, at 52 (P.R.C.) (quoting General Manager of the Hong Kong subsidiary of a Taiwanese leading investment bank as saying that the greatest advantage to list shares in Hong Kong lies in the legal flexibility to use the raised funds as compared with that in Taiwan).

²⁵⁷ See Kun-Yuan Xu, *Liang An San Di Tai Shang Chou Zi Ping Gu Zhi Yan Jiu* [IPO and SPO for Taiwan Enterprise in China, Hong Kong and Taiwan] 144, 162, 164, 168-69 (Jul. 2006) (unpublished master thesis, National Chengchi University) (on file with author) (Taiwan).

²⁵⁸ Hung-Huei Liao, *Tai Shang Xuan Ze Taiwan Huo Xiang Gang Gu Piao Shang Shi Zhi Yan Jiu* [Research of Taiwanese Enterprise's View in Deciding a Listing between Taiwan and Hong Kong Stock Markets] 55-66 (Jan. 2007) (unpublished master thesis, National Taiwan University) (on file with author)

The last empirical study involves interviews of three other Taiwanese companies, H, Y and S, all of which invest in Mainland China. H, a company having listed shares on TWSE, plans to have its subsidiary in China list shares on HKSE given that listing shares in Taiwan stock markets is subject to the Capital Controls and Constraints. Y, a company having been listed on the over-the-counter (“OTC”) market in Taiwan, plans to have its subsidiary list on Shanghai Stock Exchange in China given the problem associated with the Capital Controls and Constraints. S, a parent company having invested in China, intends to list its own shares in Taiwan first, because of complications in its industry and its business strategy. Nevertheless, S still worries about future obstacles created by the Capital Controls and Constraints.²⁵⁹

In sum, the jurisdictional competition in primary listing markets in the Greater Chinese Economy is not strictly comparable to the U.S. cross-listing (secondary listing or dual listing) markets. Nonetheless, competition for primary listings among these stock markets also leads to a law market in which Taiwanese firms with mass investment in Mainland China can select a regulatory product without being subject to the Restrictions, or instead of exposing themselves to regulatory burdens imposed by Taiwan’s government. These stock markets supply these China-based Taiwanese businesses with regulatory products of legal flexibility to use raised capital at liberty. Therefore, Taiwanese firms went public on HKSE, among others, like a torrent prior to the

(Taiwan). See also Chen-Min Hsu, *Jian Li Taiwan Cheng Wei Ya Tai Zi Chan Guan Li Zhong Xin Yu Chou Zi Zhong Xin Zhi Fen Xi (Shang)* [*The Analysis of Establishing the Center for Asia-Pacific Asset Management and Financing in Taiwan—Part I*], 114 QUAN QIU TAI SHANG E JIAO DIAN [THE E-FOCUS OF GLOBAL TAIWANESE FIRMS] (Oct. 14, 2008), <http://twbusiness.nat.gov.tw/>.

²⁵⁹ Yi-Qing Ye, *Tai Shang Gua Pai Zhi Dong Ji Yu Hui Tai Shang Shi Mo Shi Tan Tao* [The Research on Taiwanese Firms’ Motivations to List Shares and Models of Listing Back in Taiwan] 93-116 (Jul. 20, 2006) (unpublished master thesis, Soochow University) (on file with author) (Taiwan).

considerable lightening of the Capital Controls and Constraints in 2008. The physical exit or threats of exit regarding listing shares overseas thus activated the interest group competition in Taiwan's political marketplace over whether and how to relax the Restrictions.

2.2 Interest Group Competition to Seek Deregulation

Accordingly, the demand side of the law market, in the first place, sparks competition for the supply by neighboring stock markets like HKSE of a primary-listing legal environment without being subject to the Capital Controls and Constraints. The exit of Taiwanese companies seeking to avoid the Restrictions creates overwhelming costs but little benefit for anti-regulatory and exit-affected interest groups in Taiwan. Therefore, the physical exit and threats of exit drive those directly or indirectly affected by the Restrictions to voice their petition for relaxation of the Restrictions not only for themselves but also on behalf of exiting firms to an extent. The anti-regulatory interest groups include China-based Taiwanese firms represented by local chambers of commerce²⁶⁰ as well as even foreign investors mostly represented by the European Chamber of Commerce Taipei ("ECCT")²⁶¹ and American Chamber of Commerce in

²⁶⁰ For example, two major players in Taiwan are the Chinese National Federation of Industries ("CNFI") and the General Chamber of Commerce of the R.O.C. ("ROCCOC"). The former is "a non-profit organization consisting of 152 member associations in their respective fields of manufacturing industry in the Republic of China. With each member association representing its specific line of manufacturing, all the associations together stand for more than 100,000 industrial companies in this country." CNFI, <http://www.cnfi.org.tw/kmportal/front/bin/ptdetail.phtml?Rcg=100020&Part=ENGLISH-homepage> (last visited Dec. 1, 2009). The latter is also "a non-profit organization of leading commercial chambers, trade associations in the Republic of China (Taiwan). It was founded on Nov.1, 1946 mainly to represent the interests of Taiwanese business community" ROCCOC, <http://www.roccoc.org.tw/english/> (last visited Dec. 1, 2009).

²⁶¹ Tsai, *supra* note 255, at 68-69 (citing a report issued by ECCT in October 2007 that the Capital Controls also drove European firms to exit from Taiwan's markets since Taiwanese firms with whom they cooperated were so restrained that they had no other option but to dissolve their strategic alliances).

Taipei (“AmCHam”).²⁶² These anti-regulatory interest groups are all directly burdened by the Restrictions and thus promote ease of the regulation.²⁶³ The anti-regulatory interest groups’ voice appears to be so strong that some legislators²⁶⁴ and even government officials of the former ruling party DPP came out in support of them as well.²⁶⁵

Since Taiwan’s economy highly relies on foreign trade and investment, foreign investors are interesting examples of anti-regulatory interest groups which merit highlighting here. In general, foreign firms trust Taiwanese companies’ business reputation and the better-governed legal environment (e.g. intellectual property protection)

²⁶² See, e.g., *Dao Nei Gong Shang Jie Ji Wai Shang Hu Yu Tai Dang Ju Ying Song Bang Liang An Jing Mao Zheng Ce* [Local Industries and Foreign Businesses Appeal to Taiwan’s Government for Loosening Limits on Investment in the Mainland], ZHONG XIN SHE [CHINA NEWS SERVICE] (P.R.C.), Dec. 4, 2005, <http://big.china.com.cn/chinese/TCC/1050949.htm> (last visited Nov. 2, 2007); Yen-Po Tang, *Liang An Jing Mao Fa Zhan Qu Shi Yu Zhan Wang* [The Developmental Trend and Outlook of Cross-Strait Trade], 5 ZHAN WANG YU TAN SUO [PROSPECT & EXPLORATION] 20, 34 (2007) (Taiwan) (describing that both ECCT and AmCHam keenly called on Taiwan’s government to promote stronger economic ties with China—otherwise Taiwan would lose its competitiveness).

²⁶³ See *Rian He Wan Bao: Ri Yue Guang Shi Jian Xuan Gao Bian Zheng Fu Zhi Zheng Shi Bai* [United Evening News: The ASE Case Demonstrates the Failure of the Chen Administration’s Policy on Mainland-Investment Restrictions], REN MIN WANG [PEOPLE’S DAILY ONLINE] (P.R.C.), Nov. 28, 2006, <http://tw.people.com.cn/BIG5/14811/14872/5100043.html> (last visited Nov. 2, 2007); *Guan Zhi Tai Yan Taiwan Fang Di Chan Ye Cu Dang Ju Fang Kuan Deng Lu Men Kan* [Taiwan’s Real Estate Industry Appeals for Loosening Limits on Investment in the Mainland], ZHONG XIN SHE [CHINA NEWS SERVICE] (P.R.C.), Nov. 2, 2006, http://www.china.com.cn/overseas/txt/2006-11/03/content_7311026.htm (last visited Nov. 2, 2007); *Tai Shang Tou Zi Da Lu Chuang Xin Gao Bu Man Tai Lian Dang Zu Nao Liang An Kai Fang* [The Investment in the Mainland by Taiwanese Companies Hit a New High While Pro-Regulatory Legislators are Criticized for Impeding the Deregulation], REN MIN WANG [PEOPLE’S DAILY ONLINE] (P.R.C.), <http://tw.people.com.cn/BIG5/14810/4618949.html> (last visited Nov. 2, 2007).

²⁶⁴ *Lü Wei Pi Bai Fen Zhi Si Shi Shang Xian Tai Yan Ke Wang Liang An Jing Mao Da Dan Kai Fang* [A DPP Legislator Criticizes the Harshness of Limits on Investment in the Mainland and Expects a Brave Deregulation], REN MIN WANG [PEOPLE’S DAILY ONLINE] (P.R.C.), July 26, 2006, <http://tw.people.com.cn/BIG5/14812/14875/4627533.html> (last visited May. 21, 2009). In 2003, Tai-san Ciou, a DPP legislator, has already argued that if a Taiwan-invested firm has established its headquarter in Taiwan, legal barriers restraining Taiwanese enterprises’ global management and planning, such as the Capital Controls and Constraints, should also be removed. This argument is similar to one of the relaxation measures later taken since KMT took power in 2008. Ciou & Kang, *supra* note 242, at 58.

²⁶⁵ *Tai Qi Ri Yue Guang Xiao Ying Kuo Da Tai Dang Ju Mo Xu Deng Lu Shang Xian Song Bang* [Impacted by the ASE Case, Taiwan’s Government Acquired in the Direction of Loosening Limits on Investment in the Mainland], REN MIN WANG [PEOPLE’S DAILY ONLINE] (P.R.C.), Nov. 26, 2006, <http://tw.people.com.cn/BIG5/14812/14875/5101410.html> (last visited Nov. 2, 2007).

in Taiwan than China.²⁶⁶ They want to use Taiwan as their base or fortress and team up with Taiwanese businesses to enter markets in China.²⁶⁷ Therefore, once Taiwanese companies are fettered with the Restrictions and prohibited from investing in China mainly in accordance with their business demands, foreign investors will also directly assume the cost of this excessive regulation and begin to consider exiting from Taiwan.²⁶⁸ We may obtain the very answer from a quote of I-Ru Liu Team's interview with a domestic investment bank and a foreign one, both of which possess much experience as underwriters for Taiwanese companies listing shares overseas:

Many foreign investors interested in investing in China expressed that they did not trust Chinese companies and were willing to make deals with Taiwanese companies directly. Yet, Taiwan's regulation on investing in China drove away the foreign capital. Besides, many foreign firms wished to cooperate with Taiwanese

²⁶⁶ Chen-Yuan Tung, *Taiwan Dui Wai Jing Ji Zhan Lue Zhi Jian Tao Yu Jian Yi* [*The Review and Suggestion of Taiwan's International Economic Strategies*], 98 YAN XI LUN TAN YUE KAN [FORUM ON TRAINING AND DEVELOPMENT] 15, 20-21 (2009) (Taiwan).

²⁶⁷ See Koong-Lian Kao, *Taiwan Jing Ji Xu Yao Hong Guan De Liang An Jing Mao Zheng Ce* [*A Macroscopic Cross-Strait Economic Policy Is Required for Taiwan's Economy*], 1 ZHAN WANG YU TAN SUO [PROSPECT & EXPLORATION] (ISSUE 5) 38, 46 (2003) (Taiwan). For example take Japanese companies:

There are quite a few cases where strategic alliances have been formed between Taiwanese and Japanese companies in order to invest in Mainland China. There are a number of different alliances including joint ventures, Japanese companies licensing Taiwan brands and granting the use of Japanese technology to manufacture in China, Japanese companies purchasing products from Taiwanese companies in China and transferring technology to them. There is a clear picture that shows Japanese and Taiwanese companies cooperating with each other to develop the Mainland market. The primary reason for collaboration is so [sic] companies can take advantage of management systems and market development. Japanese and Taiwanese firms get along together because they have complementary qualities. Through strategic alliances, companies obtain mutual benefits and increase their competitive strengths. Taiwanese companies obtain technology and scalability from the manufacturer, which increases Taiwan's industrialization. On the other hand, Japanese companies are able to break into the Chinese market and acquire cheaper products and parts. Furthermore, collaboration has accelerated the globalization of companies, which will lead to stronger competitiveness in the world market.

Yan Zhu, *Tai Shang Da Lu Tou Zi De Ri Ben Yin Su Yu Jing Ji Quan Qiu Hua Yi Han* [*Japan's Influence on Taiwan's Globalization and Investment in Mainland China*], in JING JI QUAN QIU HUA YU TAI SHANG DA LU TOU ZI: CE LUE BU JU YU BI JIAO [ECONOMIC GLOBALIZATION AND TAIWAN'S INVESTMENT STRATEGIES IN CHINA] 319, 320 (Te-Sheng Chen ed., 2008) (Taiwan).

²⁶⁸ Li, *supra* note 255, at 81. See also Chou, *supra* note 211, at 118.

management and R & D teams to do business in China. For instance, a Swedish firm intended to buy out a leading Taiwanese company in traditional industries and wished to employ the same management in this Taiwanese company to help them invest in China. Taiwan's government, however, intervened in this deal pursuant to the Capital Controls. It was incredible for this Swedish firm to find that it was also subject to the Capital Controls that they forwarded money from abroad to Taiwan and subsequently to China for investment. This Swedish firm cannot understand that even though they were willing to make local investment and pay the tax on behalf of their Taiwanese subsidiary after the buy-out, Taiwan's government would keep preventing them from investing in China through their Taiwanese subsidiary, which meant that Taiwan's government required them to exit from markets in Taiwan. In consequence, this Sweden firm, after buying out the Taiwanese company in question, did exit from Taiwan towards China. Nothing was left in Taiwan. Taiwan lost everything.²⁶⁹

Moreover, O'Hara and Ribstein note:

[V]oice and exit intersect. When a jurisdiction loses or fails to attract people and firms because of its laws, those who forgo or lose business have an incentive to lobby to improve the law. Put differently . . . [e]xit by some can add voice to others who benefit by the presence of those who have exited. These "exit-affected groups" are then added to the mix of proregulatory and antiregulatory groups competing to enact their preferred laws. In a world of enhanced mobility, outside interests are often powerful despite their lack of physical proximity to local lawmakers.²⁷⁰

Good examples of these exit-affected interest groups in the Taiwan case are local securities industries, securities professionals, TWSE, and not least Taiwanese retail investors. The problem that the Restrictions adversely impact Taiwan stock markets can be observed from the fact that Taiwan's total capital-raising dollar amount of IPO deals

²⁶⁹ *Internationalization*, *supra* note 237, at 69.

²⁷⁰ 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, 2155 (2008).

in 2006 is the lowest during the last decade because many Taiwanese firms, following patterns similar to Hon Hai's Restructuring, do their IPOs on HKSE instead.²⁷¹ This problem can also be noted from the fact that the total number of companies listed in Taiwan has been declining according to the statistics in 2006, and even backslides to the last among East Asian Tigers—including Hong Kong, South Korea, Singapore and Taiwan. An FSC official in private admitted that one of the significant causes of this distress is the political obstacle, namely, the Restrictions which discourage China-based Taiwanese firms from listing shares in Taiwan.²⁷² Therefore, it is reasonably presumed that the financial services industry in Taiwan is one of the exit-affected interest groups that indirectly feel negative impact of the Restrictions. In particular, listing-related benefits do not come to the local financial services industries, such as investment banks, law firms, and accounting firms, (and indirectly, to their local economies in terms of tax revenue, employment rates, real estate prices and the like), as more and more China-based Taiwanese corporations do their IPOs in other capital markets, HKSE among others, to avoid Taiwan's jurisdiction. Furthermore, Gordon Shu Chen, then board

²⁷¹ *Tai Shang Shi Gong Si Chou Zi Chuang Shi Nian Xin Di* [Capital-Raising Dollar Amount of IPOs in Taiwan at the Lowest in 10 Years], PEOPLE'S DAILY (P.R.C.), Nov. 21, 2006, available at <http://tw.people.com.cn/BIG5/14812/14875/5066386.html>. See also Taying Liaow et al., *Qi Ye Jin Rong Fa Zong Lun* [The Overview of Law on Business Association and Finance], in *QI YE CHOU ZI FA WU YU GE AN FEN XI* [CASE STUDIES AND LEGAL AFFAIRS ANALYSIS OF CORPORATE FINANCING] 1, 10 (Taying Liaow et al. eds., 2008) (Taiwan) (discussing that according to TWSE's statistics from 1998 to January 2008, the number of IPOs has been decreasing since 2002 year by year).

²⁷² *Tai Gu Chen Lun Shang Shi Gong Si Zong Shu Wei Suo Diao Ya Zhou Si Xiao Long Zhi Wei* [Taiwan's Stock Market is Backsliding with the Smallest Number of Listing Companies among East Asian Tigers], REN MIN WANG [PEOPLE'S DAILY ONLINE] (P.R.C.), Nov. 27, 2006, <http://tw.people.com.cn/BIG5/14812/14875/5092097.html> (last visited Dec. 1, 2009). It is said that most Taiwanese firms that exit from Taiwan's stock markets and list shares overseas intend to get rid of impediments created by the Capital Controls and Constraints, and to seek out legal flexibility for investments in China somewhere else. According to the business community's statistics, of the capital raised by Taiwanese firms in 2004, 13% of IPOs and 60% of Secondary Public Offerings ("SPO") were done overseas; this trend accelerated. For instance, Taiwanese firms filed 40 IPO applications with HKSE in 2005 whereas there were only 17 IPO applications in Taiwan. According to Fong, this problem of listing overseas was pinpointed by a survey by McKinsey & Company that more than 200 of China-based Taiwanese firms were inclined to raise capital in Hong Kong in two or three years so as to meet their financial demand for investments in China. Fong, *supra* note 232, at 98.

chairman of TWSE (another exit-affected interest group), in May 2007 also stressed that more and more international private equity funds were coming to Taiwan to acquire Taiwan-listed companies, like the ASE case discussed below in Part B.2.2.2 of this chapter, owing to lower stock prices in Taiwan²⁷³ and to the Capital Controls. Therefore, he advocated the Restrictions should be further relaxed in the near future.²⁷⁴

More importantly, Taiwanese retail investors are also exit-affected interest groups that indirectly assume regulatory costs of the Restrictions. Specifically, the majority traders in Taiwan stock markets are domestic retail investors. For example, in 2007 they have accounted for around 70% of local stock market turnover.²⁷⁵ Taiwan had a population of 23 million in 2008, among which as many as 8.5 million had opened securities accounts.²⁷⁶ Since these ordinary Taiwanese citizens, as domestic retail investors, dominated Taiwan stock markets, they are an exit-affected interest group impacted severely when Taiwan-invested firms list shares overseas to avoid the Capital Controls and Constraints. In addition, before the relaxation of the Restrictions in the second half of 2008, in order to fully enforce the Capital Controls, the Taiwanese government restrained ordinary Taiwanese citizens from buying stocks listed in Mainland

²⁷³ In the whole year of 2007, the benchmark of Taiwanese stocks, Taipei's Weighted Price Index, rose 8.7%, and “ranked as the second-worst performing regional market behind Japan's Nikkei Stock Average, which fell 11.1%.” Chris Oliver, *Taiwan Stocks Rally after Pro-China KMT Landslide*, MARKETWATCH, Jan. 14, 2008, <http://www.marketwatch.com/story/taiwan-stocks-rally-after-pro-china-partys-election-win> (last visited Dec. 1, 2009).

²⁷⁴ *Tai Zheng Jiao Suo Dong Shi Zhang Hu Yu Song Bang Taiwan Qi Ye Fu Da Lu Tou Zi* [Chairman of Taiwan Stock Exchange Advocates Easing Mainland-Investment Restrictions], ZHONG GUO TAIWAN WANG [CHINA TAIWAN ONLINE] (P.R.C.), May 10, 2007, http://big5.chinataiwan.org/xwzx/bwzx/200705/t20070510_371567.htm (last visited Nov. 19, 2007).

²⁷⁵ Platform, *supra* note 255, at 6; James J. Kung & Wing-Keung Wong, *Efficiency of the Taiwan Stock Market*, 60 JAPANESE ECON. REV. 389, 390 (2008) (Taiwan's annual trading “drops from 89.30% in 1996 to 68.80% in 2005 for local individual investors . . .”).

²⁷⁶ Editorial, *Bu Jian Lu Shan Zhen Mian Mu, Zhi Yuan Shen Zai Ci Shan Zhong—Zong Ti Jing Ji Zhi Biao VS. “Shu Min Jing Ji” Zhi Biao* [A Layperson Could Hardly Understand Macro-Indexes—On the Indexes of Macroeconomics VS. the Reference of the “Grassroots Economy”], GONG SHANG SHI BAO [INDUSTRY & BUS. TIMES] (Taiwan), Sep. 21, 2009, at A2.

China, Hong Kong and Macau through stock brokers located in Taiwan. Both offshore and domestic mutual funds offered and sold in Taiwan could not invest more than 0.4% of their net asset values in stocks listed in Mainland China and 10% in stocks listed in Hong Kong and Macau.²⁷⁷ Therefore, due to the Restrictions, Taiwanese retail investors are deprived of opportunities to directly and indirectly share the returns from these prosperous China-based Taiwanese firms as these companies do not list shares in Taiwan.²⁷⁸ Perceiving the former DPP government maintaining and even re-tightening the Capital Controls in 2006 as discussed below in Part B.1.2.3, Taiwanese retail investors could arguably join anti-regulatory groups in the March presidential election in 2008 as a strong exit-effected interest group given that they were a large percentage of voters.²⁷⁹ The influence of these retail investors²⁸⁰, who should have benefited from

²⁷⁷ Chang Kao & Cheng-Hsu Wang, *Liang An Guan Xi De Hui Gu Xin Qing Shi Yu Qian Zhan* [*The Review, New Circumstances and Foresight of Cross-Strait Relationship*], 9 YUAN JING JI JIN HUI JI KAN [PROSPECT Q.] (ISSUE 3) 167, 188 (2008) (Taiwan); Jing Wai Ji Jin Tou Zi Gang Gu Xian Zhi Wan Quan Qu Xiao Zheng Yuan Tong Guo [*The Executive Yuan Lifted the Bans on Offshore Mutual Funds' Investing in Stocks Listed in Hong Kong*], FA YUAN FA LU XIN WEN [LAWBANK'S L. NEWS] (Taiwan), July 4, 2008, http://www.lawbank.com.tw/fnews/news.php?keyword=%B9%D2%A5%7E%B0%F2%AA%F7%A7%EB%B8%EA%B4%E4%AA%D1%AD%AD%A8%EE%A7%B9%A5%FE%A8%FA%AE%F8&sdate=&date=&type_id=1,10,19,20,21,22&total=1&nid=61411.00&seq=1 (last visited Dec. 1, 2009).

²⁷⁸ Chou, *supra* note 211, at 118; 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 [hereinafter *UMC*] (reporting that the Restrictions compelled Taiwanese firms to delist from Taiwan and list shares in Hong Kong, that the Capital Controls led offshore mutual funds to retreat from Taiwan, and that for the last three years 23 offshore mutual funds have left Taiwan such that products of investment Taiwanese investors can choose turned fewer).

²⁷⁹ After the legislature election on the weekend in January 2008 in which the then-opposition party KMT won a landslide victory, Taiwanese stocks climbed sharply by 1.8%, or 144.1 points to 8,173.41 immediately on Monday. The news report from MarketWatch said:

"The election signals a reordering of national priorities toward growth and commercial prospects, and away from idealistic issues such as national identity," said Bear Stearns strategist Michael Kurtz in a research note Monday.

Saturday's result saw the Kuomintang take 81 seats with 51.3% of the popular vote while the Democratic Progressive Party held on to 27 seats, with a 36.9% share of the vote.

Taiwanese President Chen Shui-bian stepped down as chairman of the DPP hours after the results were announced. A key pillar of Chen's administration had been Taiwan's independence from China.

. . . .

"With the KMT in power investors in general feel that the policies will be more turning

Taiwan-invested corporations' local listings, might help explain the interest group competition on the supply side within Taiwan's political marketplace.

In consequence, the Restrictions not only forced Taiwanese companies with substantial investment in China to list their shares abroad, mostly on HKSE, to raise capital for investments in Mainland China, but also discouraged many China-based Taiwanese businesses not yet doing their IPOs from listing stocks back at home. Wave upon wave of leading large conglomerates in Taiwan like Hon Hai decided to have their business substantially based in China exit from Taiwan. This physical exit substantially undermined Taiwan's reputation as an investment environment. Afterwards many foreign investors, direct or indirect, gradually lost their confidence in Taiwan's markets and exited as well. The physical exit and threats of exit bolstered the voice rights of anti-regulatory and exit-affected interest groups, thus helping them dominate the arena especially in the March presidential election in 2008. This can be evidenced by the fact

towards collaboration with China," [Pauline Dan, a fund manager with MFC Global Investment Management,] said, adding *the KMT was likely poised to win the upcoming presidential elections*.

....

Analyst said the DPP's thrashing at the polls and subsequent resignation of Chen will likely inspire *a shift in the party's strategy towards economic and environmental issues to win back voters*. *A softer approach by the DPP* would like mean fewer political flare-ups between Beijing and Taipei regardless of who's in power.

"The DPP will attempt to rebrand itself in the future as a more moderate party, which . . . could shift Taiwan's entire political center of gravity rightward," Bear Stearns' Kurtz.

Oliver, *supra* note 273 (emphasis added) (alteration in original). This quote could to some extent imply that investors in general, a large percentage of which are the retail investors, show their confidence in KMT's potential victory in the March presidential election with the rise of the stock market index, and that retail investors as an exit-affect interest group may arguably join anti-regulatory interest groups to push for the moderation of the Capital Controls in the arena of the presidential election.

²⁸⁰ To illustrate their influence in another context, in early August 2007 when the U.S. financial crisis had just started, as Taipei's Weighted Price Index was also negatively impacted and thus plunged by around 10%, it is argued that the pressure from retail investors was so great that Taiwan's government was pushed to intervene in the stock market by buying stocks with money from public pension and retirement funds, insurance funds and deposit funds of post offices, in order to stop the drop. Editorial, *Cong Liang Jian Shi Kan Zheng Fu Shi Zheng Pin Zhi* [*Observing the Quality of the Government Administration in Light of Two Incidents*], GONG SHANG SHI BAO [INDUSTRY & BUS. TIMES] (Taiwan), Aug. 6, 2007, at A2.

that prior to the presidential election, candidates from both major parties similarly suggested in the second half of 2007 that the Capital Controls should be relaxed.²⁸¹ As Coates explains why SOX was then enacted, “[i]n a democracy in which most voters own stock either directly or indirectly through their pension and retirement funds, government was certain to react. The only question was the shape the reaction would take.”²⁸² Similarly in Taiwan, since the Restrictions substantially adversely impacted Taiwan stock markets, the pressure on politicians of both parties to lighten the Restrictions—especially from a huge number of retail investors as an exit-affected interest group—was so great that maintaining the Restrictions was not an option. In other words, it is likely that anti-regulatory and exit-affected interest groups’ voice rights strengthened by exit were successfully exercised to push presidential candidates from both camps to advocate the easing of the Capital Controls. Therefore, because of these firms’ continuous exit from local markets, Taiwan, under the decisive interest group competition over whether and how to deregulate, experienced a radical change of political power in the first half of 2008 as Chang-Ting Hsieh (Frank Hsieh), from the former President Chen’s own DPP, was defeated while President Ying-Jeou Ma of KMT, advocating anti-regulatory and pro-China policies, won the presidential election. An editorial in the *China Times*, a major Taiwanese newspaper, argued that when in power in Taiwan, the more proactively the former DPP government intended to contain Taiwan’s outward investment in Mainland China, the more sophisticated tactics these firms would take to evade the Capital Controls while investing more in Mainland China, and that since the DPP government overlooked the voice for relaxation of the Capital Controls from KMT and

²⁸¹ Chou, *supra* note 211, at 3-4.

²⁸² John C. Coates, *The Goals and Promise of the Sarbanes–Oxley Act*, 21 J. ECON. PERSP. 91, 91 (2007).

the business community, Taiwanese citizens just voted out DPP to say no to the re-tightened regulation in 2006.²⁸³ Apparently, pro-regulatory interest groups in Taiwan failed. Immediate relaxation of the Restrictions was under way.²⁸⁴

2.3 Ensuing Liberalization

President Ma in his interview on June 18, 2008 by New York Times and The International Herald Tribune said:

There are so many Taiwanese businesspeople around the area [who] now keep their money out of Taiwan. You know, in the last five, four years, many Taiwanese companies went public on Hong Kong's stock exchange. More than 60 of them. Large companies. Without even thinking about coming back to Taiwan. Some even left Taiwan's stock market to invest in the mainland. So that was really, you know,

²⁸³ Editorial, *Min Jin Dang Hai Yao Bu Yao Chong Fan Zhi Zheng?* [Does DPP Want to Come Back into Power?], ZHONG GUO SHI BAO [CHINA TIMES] (Taiwan), Apr. 13, 2009, available at <http://news.chinatimes.com/2007Cti/2007Cti-News/2007Cti-News-Content/0,4521,11051402+112009041300109,00.html>.

²⁸⁴ Lin Lin, *Mei Bao: Shi Xian Xuan Zhan Cheng Nuo Ma Ying-Jeou Jiang Mian Lin Zhong Da Tiao Zhan* [Wall Street Journal: To Implement His Promise during the Campaign President Ma Will Face Major Challenges], ZHONG YANG SHE JI SHI XIN WEN [CENTRAL NEWS AGENCY NEWS], Mar. 23, 2008, <http://tw.news.yahoo.com/article/url/d/a/080324/5/vxu.html> (last visited Mar. 23, 2008). As Bradsher reports,

President Ma Ying-jeou of Taiwan called on Wednesday for a rapid expansion of economic relations between Taiwan and mainland China over the next year or two. . . . Mr. Ma said he wanted broad access to the mainland market for Taiwanese financial services businesses, an end to double taxation by government agencies in Taipei and Beijing and *the removal of investment restrictions*. . . . Mr. Ma led his Nationalist Party to a decisive victory in the March elections, prevailing over a candidate warier of closer ties with mainland China. Mr. Ma had promised to strengthen the Taiwanese economy through reconciliation

Keith Bradsher & Edward Wong, *Taiwan's Leader Outlines His Policy toward China*, N.Y. TIMES, June 19, 2008, available at http://www.nytimes.com/2008/06/19/world/asia/19taiwan.html?_r=1&sq=China%20Taiwan&st=cse&oref=slogin&scp=4&pagewanted=print (emphasis added). Hui-Ru Zhou, *Ma Xiao Xin Zheng—Fan Suo Guo Jing Ji Wei Wang* [President Ma's New Deal: Stop Closing Taiwan to Cross-Strait Exchanges and the Economy Is the King], DA LU TAI SHANG 1000 DA: LIANG AN HE PING SHENG SHI TAI SHANG DA FU HUO [TOP 1000 OF CHINA-BASED TAIWANESE FIRMS: CROSS-STRAIT PEACE RISES AND TAIWANESE BUSINESSES WILL THRIVE AGAIN], June 6, 2008, at 42 (Taiwan) (arguing that in the 2008 presidential election Ying-Jeou Ma of KMT won more than half of the votes, which showed that relaxation of regulation on cross-Strait trade and investment was expected by most people in Taiwan).

very bad for Taiwan. Now, we certainly want to change that. We want to attract more foreign capital, and capital of [locally-based] companies that have made billions of dollars on the Chinese mainland.²⁸⁵

Therefore, the KMT government started a series of relaxations of the Capital Controls and Constraints. First, MOEA revamped the Capital Controls, mainly Point 3 of the Principles, to loosen the upper limit of investment in China, or increase Investment Allowance, from 40 % to 60% of a corporation's net worth. Furthermore, if a corporation is qualified by MOEA to be a subsidiary of a Multi-National Enterprise or to establish its headquarter in Taiwan, there will be no upper limit for this corporation. Responding to the large-scale relaxation of the Capital Controls, the FSC revised the Constraints as follows:

- (1) Article 7 of Regulations Governing the Offering and Issuance of Securities by Securities Issuers is revised so that Taiwanese issuers are allowed to directly or indirectly invest up to 60% of capital raised in Taiwan stock markets in Mainland China.
- (2) According to the revised Capital Controls the FSC declared that public Taiwanese companies can use up to 60% capital raised through each private placement, no matter whether located in Taiwan or overseas, for investments in Mainland China.²⁸⁶
- (3) Subsequent to the revision of Article 9 of Regulations Governing the Offering and Issuance of Overseas Securities, funds raised from the issuance of securities in overseas stock markets in each offering are all allowed to be used for direct or indirect investments in Mainland China despite the upper limit, 60% of net worth.
- (4) After Regulations Governing the Offering and Issuance of Securities by Foreign Securities Issuers are revised, funds raised in Taiwan stock markets by foreign issuers can all be used for investments in Mainland China. Hence, a parent company in Taiwan such as Hon Hai can, as they see fit themselves, invest in Mainland China through its foreign subsidiary like FIH which is incorporated in the Caymans Islands.

²⁸⁵ *An Interview With President Ma Ying-jeou*, N.Y. TIMES, June 19, 2008, available at <http://www.nytimes.com/2008/06/19/world/asia/19taiwan-interview.html?ref=asia>.

²⁸⁶ *Placements*, *supra* note 179.

In another word, a Taiwanese parent company can first establish a holding company in an OFC and have this offshore company list shares in Taiwan stock markets. Since this offshore subsidiary or affiliate is a foreign issuer, the capital raised by this offshore company is not subject to the Capital Controls and can all be used for investments in China.²⁸⁷

These measures seemed to have broadcast messages of liberalization successfully. Hon Hai thus started to take into account founding its Asian logistics hub in southern Taiwan, and having its subsidiary FIH (already listing shares on HKSE) list its TDRs back in Taiwan.²⁸⁸ The FSC added that, by October 2008, 54 China-based Taiwanese businesses expressed their intense willingness to list their shares or TDRs in Taiwan. 30 of these firms planned to cross-list on TWSE by issuing TDRs while the rest 24 of them intended to do primary-listings by directly listing shares in Taiwan's OTC market.²⁸⁹ Accordingly, more and more Taiwanese firms already incorporated overseas and listing shares in China or Hong Kong began to contemplate listing shares back in Taiwan or even moving back their headquarters towards their motherland. For example, Want Want

²⁸⁷ See Rui-Yi Zhang & Shu-Fang Zheng, *Fa Ling Song Bang Tai Gu Yue Ju Tai Shang Shang Shi Shou Xuan* [With the Laws Relaxed Taiwan Stock Markets Are Turning into the First Choice for Taiwanese Firms' Listing Shares], GONG SHANG SHI BAO [INDUSTRY & BUS. TIMES] (Taiwan), Mar. 9, 2009, available at <http://news.chinatimes.com/CMoney/News/News-Page-content/0,4993,11050802+122009030900284,00.html>; also An-Ni Lin, *Tai Shang Ke Yi Kong Gu Ming Yi Hui Tai Shang Shi Bu Shou Deng Lu Bai Fen Zhi Liu Shi Shang Xian Xian Zhi Mian Jiao Bai Fen Zhi Er Shi Wu Ying Suo Shui* [Taiwanese Firms Can List Back in Taiwan in the Name of Holding Companies, Which Is Not Subject to the 60% Upper Limit on Investment in the Mainland and the 25% Profit-seeking Enterprise Income Taxation], JING JI RI BAO [ECONOMICS DAILY] (Taiwan), Aug. 2, 2008, at A6.

²⁸⁸ Zong-Zhi Liu & Qiong-Yu Yan, *Hong Hai Za Qian Yi Jian Shu Wei Huan Bao Ke Ji Cheng* [Hon Hai Will Spend More than 100 Billion NT Dollars on Establishing A Digital Eco-Tech City], ZHONG SHI DIAN ZI BAO [CHINA TIMES DAILY NEWS] (Taiwan), Aug. 7, 2008, available at <http://tw.news.yahoo.com/article/url/d/a/080807/4/noh.html>; *Hong Hai Zi Gong Si Fu Shi Kang Chou Hua Hui Tai Shang Shi* [FIH Is Planning for Listing Back in Taiwan], ZHONG GUANG XIN WEN WANG [BCC NEWS NETWORK] (Taiwan), Aug. 6, 2008, <http://tw.news.yahoo.com/article/url/d/a/080806/1/mdl.html> (last visited Aug. 7, 2008).

²⁸⁹ Xiang-Zhi Xue & Zhen-Ling Peng, *Jin Guan Hui: Wu Shi Si Jia Tai Shang Fan Xiang Shang Shi* [FSC: 54 Taiwan Companies Will List Back at Home], GONG SHANG SHI BAO [INDUSTRY & BUS. TIMES] (Taiwan), Nov. 5, 2008, available at <http://news.chinatimes.com/CMoney/News/News-Page/0,4442,content+120601+122008110500317,00.html>.

China Holdings Limited (“Want Want China”), a Taiwan-invested firm and the largest maker of rice cakes and flavored milk in China, was incorporated in the Cayman Islands, headquartered in Shanghai, and listed on HKSE in 2007. In light of the large-scale liberalization of the Restrictions, Want Want China became the first runner for listing TDRs on April 28, 2009 to back up the Ma administration’s regulatory transition to more legal flexibility.²⁹⁰ In addition, Natural Beauty, a franchise chain of cosmetics originating in Taiwan, headed towards China to develop the Chinese market more than a decade ago and listed its shares in Hong Kong in 2002. Nevertheless, Natural Beauty returned to Taiwan to set up its global headquarters in Taipei on November 25, 2008.²⁹¹ Under the cluster effect of industries, foreign firms attempting to carve out their business in Mainland China may follow Taiwan-invested firms’ steps, and the inflows of FDI into Taiwan may be in an upsurge again.²⁹² Consequently, accounting, legal services and other industries or markets supporting capital markets and local corporate headquarters

²⁹⁰ Zong-Tong Wang, *Hui Tai Gua Pai Shang Shi Zhong Guo Wang Wang Qiang Tou Xiang [Want Want China Is the First Runner to Be Listed Back in Taiwan]*, ZHONG GUO SHI BAO [CHINA TIMES] (Taiwan), Apr. 1, 2009, available at <http://news.chinatimes.com/2007Cti/2007Cti-News/2007Cti-News-Content/0,4521,5010502+11200904010345,00.html>; Hong-Hui Guo, *Zhong Guo Wang Wang TDR Jin Zheng Shi Shang Shi! [Want Want China Is Listing Its TDRs Today!]*, ZHONG SHI DIAN ZI BAO [CHINA TIMES DAILY NEWS] (Taiwan), Apr. 28, 2009, available at <http://news.chinatimes.com/2007Cti/2007Cti-News/2007Cti-News-Content/0,4521,5010860+132009042800566,00.html>.

²⁹¹ Li-Man Li, *Cai Yan Ping Hui Tai She Quan Qiu Zong Bu [The Founder of Natural Beauty Is Going Home to Set Up the Global Headquarter]*, GONG SHANG SHI BAO [INDUSTRY & BUS. TIMES] (Taiwan), Nov. 19, 2008, available at <http://news.chinatimes.com/CMoney/News/News-Page/0,4442,content+120601+122008111900387,00.html>.

²⁹² See, e.g., Mo-Yun Wang, *Hu Di Wen: Liang An Reng Xu Jia Kuai Kai Fang Jiao Bu [Bayer’s Head in Taiwan Branch: Deregulation of Taiwan’s Cross-Strait Policy Should Be Accelerated]*, ZHONG GUO SHI BAO [CHINA TIMES] (Taiwan), Oct. 9, 2008, available at <http://news.chinatimes.com/2007Cti/2007Cti-News/2007Cti-News-Content/0,4521,110507+112008100900035,00.html> (reporting that the board chairman of the Taiwanese subsidiary of Bayer, a German chemical and pharmaceutical company, expressed that even though there is a global economic downturn, Bayer promises to establish two major R & D centers in Taiwan, given that teaming up with Taiwanese firms Bayer can process orders in Taiwan while final products can be manufactured in Mainland China and Vietnam and shipped from there).

would be thriving again.

Finally, according to a study by Jia-Ke Hung and Chen-Yuan Tung, before the large-scale lightening of the Capital Controls in 2008, the Capital Controls drove TDI in China to change into underground economic activity by circuitously transferring Taiwanese funds to corporations registered in OFCs such as the Cayman Islands and BVI and later investing these funds in China. These funds were not indentified by both Taiwanese and Chinese officials as TDI.²⁹³ From 1979 to 2008, if these funds transited via the Cayman Islands and BVI were recognized as TDI in China, Taiwanese capital would be estimated to be approximately \$122.285 billion, which is 14.34% of total FDI in China as well as the second largest FDI inflow to China (FDI from Hong Kong and Macau still ranked as the top one), even though TDI at face value in the same period is indentified as the fifth largest FDI (the top four in order: Hong Kong and Macau, BVI, Japan, and the U.S.) according to Chinese statistics.²⁹⁴ This number of TDI in China (\$122.285 billion) has so far been recognized by many Chinese and Taiwanese scholars as the closest to the reality.²⁹⁵

On the other hand, according to FDI statistics made public on Sep. 15, 2009 by

²⁹³ Jia-Ke Hung & Chen-Yuan Tung, *Tai Shang Dui Zhong Guo Jing 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: *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 & Foresight] 5-6 (Oct. 3-4, 2009) (on file with author).

²⁹⁴ *Id.* at 7-8.

²⁹⁵ Wen-Hui Li, *Zi Xun Bu Ming Zao Cheng Yan Jiu Kun Nan* [The Insufficiency of Information Creates Difficulties over Research], *ZHONG GUO SHI BAO* [CHINA TIMES] (Taiwan), Oct. 23, 2009, available at <http://news.chinatimes.com/2007Cti/2007Cti-News/2007Cti-News-Content/0,4521,50501637+112009102300154,00.html>; Wen-Hui Li, *Xue Zhe Yan Jiu Tai Shang Dui Lu Gong Xian Du Pai Di Er* [According to the Scholar's Study Taiwan Is Ranked as the Second Largest FDI in China], *ZHONG GUO SHI BAO* [CHINA TIMES] (Taiwan), Oct. 23, 2009, available at <http://news.chinatimes.com/2007Cti/2007Cti-News/2007Cti-News-Content/0,4521,50501637+112009102300150,00.html>.

PRC's Ministry of Commerce, as the Capital Controls are largely relaxed in the second half of 2008, TDI at face value climbed from the ninth largest FDI inflow to China in 2008 to the second largest (only second to Hong Kong) in the period of January-August 2009, without the inclusion of Taiwanese funds circuitously through those OFCs. Also, in the same period, FDI from OFCs including BVI, the Cayman Islands, Samoa, Mauritius and so forth turned out to be out of top 10 FDI inflows to China. Although OFCs' lower ranking was possibly owing to the fact that PRC's tax authorities recently strengthened their investigation of tax evasion via OFCs, it was more likely that the liberalization of the Capital Controls started in the second half of 2008 substantially removed Taiwanese firms' incentives to indirectly invest in China via OFCs such as BVI and the Cayman Islands, which thus galvanized the considerable increase of TDI in China at face value.²⁹⁶ The above evidence explicates that the Capital Controls enforced from 1997 to 2008 as discussed below in Part B.1.2 cannot overcome the market reality that Taiwanese firms' vigorous business demands rendered themselves the second largest FDI inflow to China from a perspective of substance, and that Taiwanese capital emerging from underground thanks to the relaxation in question largely narrowed the gap between official estimation and Taiwanese firms' real investment value to China.

3. Comparisons between the Phenomena of the Sarbanes-Oxley Act and Taiwan

3.1 Differences

²⁹⁶ Zhang-Rong Kang, *Taiwan Jin Nian Yue Sheng Ya Jun* [Taiwan Rises to the Runner-up this Year], GONG SHANG SHI BAO [INDUSTRY & BUS. TIMES] (Taiwan), Sep. 16, 2009, available at <http://news.chinatimes.com/CMoney/News/News-Page-content/0,4993,11050706+122009091600245,00.html>.

What implications can we derive from the cross-listing competition in the SOX case discussed in Chapter 2.B and the primary-listing competition in the Taiwan case? Before comparing the actual scope of loosening the regulation in both cases, some might suppose that there should be certain differences to the extent that cross-listing markets in SOX's case should impose more discipline upon U.S. government than primary-listing markets in the Greater Chinese Economy upon Taiwan's government. They might advance the hypothesis that it would be easier for cross-listing firms to exit from U.S. markets than Taiwanese firms to exit from their home country. Accordingly, global cross-listing markets would, in theory, exercise more discipline on US government than primary listing markets in Taiwan's case upon Taiwan's government, in that costs of foreign issuers' exiting from US markets are lower than those of Taiwanese firms' exiting from Taiwan's stock markets, and that the mobility of foreign firms in SOX's case is thus higher than Taiwanese firms'. Nevertheless, the truth is that the SEC merely makes partial exemptions for foreign firms and even fewer substantive changes for domestic issuers whereas Taiwan's government makes such a large-scale substantive change on the Capital Controls and Constraints. Therefore it seems that the above hypothesis is wrong. Why?

We might come forward with the following explanations. First, as Hart argues, the best explanation to enact SOX is "that the pressure on politicians to act—from the public, interest groups, and the politicians themselves—was so great that nonintervention was not an option."²⁹⁷ The U.S. thus has a stronger need to regulate domestic firms than foreign firms to react to corporate catastrophes like Enron's. With respect to the

²⁹⁷ Oliver Hart, *Regulation and Sarbanes-Oxley*, 47 J. ACCT. RES. 437, 444 (2009).

regulatory necessity, cross-listing firms are not as important as domestic firms. Therefore, in order to retain or attract back foreign issuers, the U.S. government is willing to supply foreign issuers with some exemptions while maintaining the intensity of the regulation on domestic issuers.

Second, even if many Taiwan-invested firms are incorporated overseas, their direct or indirect equity owners are mostly still Taiwanese who generally have stronger voice in Taiwan's political marketplace than foreign issuers in the U.S. politics. Therefore, foreign issuers could pressure the SEC to exempt them from some SOX mandates merely via their exit and weaker voice in the U.S., whereas Taiwanese firms can exert greater pressure on Taiwan's government in the legislature and especially in the presidential election in 2008 to liberalize the Restrictions on a large scale. This is largely because 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 2008.²⁹⁸ This probably drove the

²⁹⁸ Immediately subsequent to KMT's landslide victory of the legislature election in January 2008, stock analysts indicated that "[w]ith the KMT in power investors in general feel that the policies will be more turning towards collaboration with China," and that "the KMT was likely poised to win the upcoming presidential elections." Oliver, *supra* note 273. This might, as discussed above, suggest that the Capital Controls were so against general investors' interests as to tilt to KMT their potential support for the triumph of the prospective presidential election in March 2008. Also, after President Ma was sworn in May 2008, Horng-Ming Tsai, the Vice Secretary General of CNFI (one of the two major Taiwanese chambers of commerce), was invited to accept the honorary position of Advisor of National Security Council and then became an adviser to President Ma. See Fong-Ying Chen, *Gao Charng Tsai Horng-Ming Ru Lie Deng Lu Song Bang You Wang* [With Charng Gao and Horng-Ming Tsai Joining the Ma Administration Bans on Investment in China Are Expected to Be Lifted], ZHONG GUO SHI BAO [CHINA TIMES] (Taiwan), May. 12, 2008, available at <http://news.chinatimes.com/2007Cti/2007Cti-News/2007Cti-News-Content/0,4521,110501+112008051200058,00.html>; Ci-Ti Cui, *Guo An Hui Zi Wei Tsai Horng-Ming Ci Zhi Tsai Wei Chan Ye Jie Zai Guo An Hui De Wei Yi Dai Biao Shi Fou Yin Fa Gu Pai Xiao Ying Bei Shou Guan Zhu* [Horng-Ming Tsai Resigns His Commission as Advisor of National Security Council; Given Tsai Is the Only Representative from the Business Community in that Council Whether His Resignation Will Bring About A Domino Effect Deserves to Be Watched], GONG SHANG SHI BAO [INDUSTRY & BUS. TIMES] (Taiwan), Aug. 24, 2009, at A2. Before KMT won the presidential election, Mr. Tsai had written many articles to advocate the relaxation of the Capital Controls, which resonated with CNFI's consistent petition. Given that Tsai engaged the service of

presidential election candidates from both major parties to countenance the petition that the Capital Controls should be further relaxed. Put simply, the Restrictions deterring Taiwanese firms from making significant local investments and listing shares at home trigger a larger local political backlash against the regulation than in SOX's case.

Third, as compared with Taiwan, the U.S. is a much larger and richer country and has a more captive market that local interest groups can exploit, in part, by lobbying to assure the maintenance of regulatory intensity on domestic issuers.²⁹⁹ Meanwhile, domestic firms more tied to the U.S. market are more stuck in their home country and thus less mobile than foreign firms, because the former rely more on listing shares in the U.S. stock markets to develop or keep their reputation for local business³⁰⁰ whereas the latter can just exit and go public in other markets such as LSE. The U.S. political jurisdiction can thus enforce her laws against domestic firms that have higher costs of

the close advisor to President Ma after the election, it might, at least partially, be argued that before the election the Capital Controls would prompt businesses to shift to KMT in terms of support such as campaign contributions or endorsements. More importantly, the endorsement from the business community for Ma's bid for presidency might be confirmed by the fact that when Mr. Ma attended the Conference of Chairpersons of Taiwanese Chambers of Commerce in China, most attendant China-based Taiwanese businessmen publicly expressed their support to KMT and Mr. Ma in the presidential election. *See Min Jin Dang Guang Shuo Bu Zuo Tai Shang Qun Qi Ting Lan [DPP Only Pays Lip Service without Any Actual Action; Taiwanese Businessmen Altogether Support KMT]*, ZHONG GUO PING LUN XIN WEN [CHINA REVIEW NEWS] (P.R.C.), June 4, 2007 <http://www.chinareviewnews.com/doc/1003/8/1/4/100381470.html?coluid=7&kindid=0&docid=100381470> (last visited Dec. 3, 2009) (reporting that even if both Mr. Ma and Mr. Hsieh advanced the similar policy to open up cross-Strait exchange, most Taiwanese businessmen said they did not trust the latter and DPP, but believed that the victory of the former and KMT would really help them out).

²⁹⁹ There is an analogous discussion under the U.S. Federalism by O'Hara and Ribstein:

The discipline that mobility exerts on state politicians depends on the benefits states can offer firms to offset bad laws. The more desirable a location is because of its non-law attributes such as its labor pool, its extensive consumer market, or its plentiful natural resources, the more it can get away with harsh regulations promoted by local interest groups. We would therefore expect large and rich states like California to be less responsive to the law market than small states like Delaware. In short, physical mobility works to enhance, but not to guarantee, the enforcement of choice-of-law clauses.

O'HARA & RIBSTEIN, *supra* note 27, at 68.

³⁰⁰ See BUTLER & RIBSTEIN, *supra* note 109, at 74.

exit. Put somewhat differently, domestic firms would be less willing than foreign issuers to incur the costs of listing shares outside the United States. Conversely, cross-listing firms are less locally based and more likely to be listed somewhere except the U.S. stock markets. Since foreign issuers are less tied in the U.S. captive market and have greater ability to expatriate than domestic firms, they are relatively less burdened by the costs of shopping for laws in the global cross-listing markets.

By contrast, Taiwan has been an economy heavily relying on foreign trade and investment, without a comparably captive market as the U.S. does to keep domestic firms home and even lure foreign issuers from elsewhere. Because, to Taiwanese and foreign firms with the intent and need to invest in China, Taiwan's local markets are not as attractive as broader markets in China, Taiwan-invested firms that are mobile enough are more incentivized to exit from Taiwan so as to evade the Capital Controls and Constraints. In order to react to these firms' continuous exodus, Taiwan's government is pressured to lighten the Restrictions significantly. Therefore, this demonstrates that primary-listing markets in Taiwan's case impose more discipline than cross-listing markets in SOX's case.

Nonetheless, globalization promotes mobility of capital and talent, or of firms, and then reduces their costs of exit from a country. This in turn helps materialize the rise of international jurisdictional competition, or international law market. What implications can we gather from this phenomenon? We can observe a lesson from a perspective of business strategy. Mihir Desai argued:

Following the uproar over Stanley Works proposed move to Bermuda, for example,

the United States enacted legislation that limits the ability of U.S. firms to change their legal domicile. . . . Such efforts may work in the short run for very large countries. They will likely fail for smaller countries that cannot censure companies by withholding government contracts. And they will surely fail in the long run as the global market for corporate control can circumvent local efforts to retain ownership. In other words, saying an American corporation can't leave for Bermuda is a recipe for a foreign acquirer to buy the American firm and achieve the same result in other ways.³⁰¹

Therefore, in the long run, whether jurisdictions are large countries and possess local captive markets or not, they are treated equally by law market forces underlying international jurisdictional competition. That is, if their regulation on firms is over-burdensome, they would all be disciplined by the international law market and then pressured to moderate the excessive regulation to some degree.

3.2 Similarities

As for how the law market operates, O'Hara and Ribstein argue:

Our analysis of the market for law begins with the role of party mobility in producing a kind of market for public goods, or government services. We then extend that market concept to consider markets for law, in which people select among given packages of legal rules, and, in turn, these selections also help shape the laws that states offer.³⁰²

International jurisdictional competition of securities regulation in both cases of the U.S. and Taiwan similarly illustrates the above market for law in action.

³⁰¹ Mihir A. Desai, *The Decentering of the Global Firm*, 32 *WORLD ECON.* 1271, 1282 (2009).

³⁰² O'HARA & RIBSTEIN, *supra* note 27, at 27.

In the case of SOX, jurisdictional competition in securities regulation is through cross-listing markets—that is, listing ADRs on American stock exchanges outside their home country. As Ribstein & O’Hara discuss,

The demand side of this market consists of [FPIs] that seek to “bond” their disclosures by willingly subjecting themselves to tight U.S. disclosure standards and fraud rules [or the regulation provided by other advanced markets such as LSE]. On the supply side, interest groups in cross-listing countries, including lawyers, accountants, and investment bankers, get significant benefits from cross-listing and therefore incur costs if cross-listings dry up. This law market is quite competitive, since cross-listing firms can fairly easily avoid the United States and stay home or go to other capital markets like London if the cross-listing country raises the cost or lowers the benefit of its regulation. All of this was brought home with a thud when foreign companies started avoiding the United States after the adoption of stringent new regulation in the Sarbanes-Oxley Act.³⁰³

In other words, FPIs take the “exit” option to respond to decline in benefit of the cross-listing regulatory product created by SOX. The demand force in turn sparks the supply force within the United State. That is to say, both the anti-regulatory interest groups on behalf of FPIs and exit-affected interest groups like the U.S. law firms who are affected by the exodus of cross-listers take the “voice” option to pressure the U.S. government to partially exempt foreign issuers from U.S. law.

In the case of the Capital Controls and Constraints in Taiwan, jurisdictional competition among global legal centers occurring in the Greater Chinese Economy is through primary-listing markets—that is, listing shares for the first time on securities exchanges outside Taiwan. Due to the excessiveness of the regulation on outward

³⁰³ Ribstein & O’Hara, *supra* note 8, at 711 (alteration in original) (footnote omitted).

investment in China, Taiwanese firms with major investment in China cannot but exit from Taiwan's stock markets and through evasive tactics seek out a regulatory product without being subject to the Constraints, in order to raise necessary funds to meet financial demand of investments on the Mainland. On the supply side, most of these Taiwanese firms go public on HKSE primarily to "avoid" the Restrictions, rather than to "bond" their insiders by willingly subjecting themselves to seemingly a little stricter Hong Kong laws. The torrential "exit" of these Taiwanese firms could therefore activate interest group competition in Taiwan to seek the relaxation of the Restrictions. Finally, anti-regulatory interest groups arguably joined by exit-affected interest groups, mainly represented by local retail investors, successfully voice their petition for liberalization. A series of large-scale relaxation measures are thus followed subsequently.

The fact that Taiwan's government enforces the regulation on investment in China equals wielding its local regulation against foreign companies as domestic firms turn into pseudo-foreign corporations to a degree. This scenario resembles the U.S.'s attempt to enforce its securities regulations against foreign issuers listing in the U.S. stock markets. The similarity rests on that both Taiwan and the U.S. intend to expand their local regulation extra-territorially against corporations incorporated in a foreign jurisdiction. Nevertheless, the U.S., a global superpower with a relatively captive market that local interest groups can exploit, still confronts "difficulties in enforcing disclosure regulations against foreign firms because of problems of gathering evidence, particularly given U.S. pleading and discovery burdens. Accordingly, it must rely on foreign cooperation."³⁰⁴ On the other hand, compared with the U.S., Taiwan is a Lilliputian state and barren locale

³⁰⁴ Ribstein, *supra* note 51, at 108.

with fewer chips to bargain over the type of regulatory cooperation with Hong Kong and other OFCs such as the Cayman Islands, all of which also compete for benefits derived from corporate charters, listings and other related local economic transactions of China-based Taiwanese companies. Therefore, Taiwan certainly faces a higher difficulty of enforcement, which meanwhile highlights one of the problems created by the Capital Controls. The other problem is that, as discussed above, there is little benefit and tremendous cost to deviating from the market realities of comparative advantages generated by economic complementation between China and Taiwan under economic globalization, as well as ignoring business demands for investment in Mainland China accordingly.

As in the SOX context, the elements of the law market story apply in the international context. From the case study showing that Taiwanese companies' exit to elude the Restrictions brings about large-scale ease of investment limits, we can learn that the jurisdictional competition among listing markets in the Greater Chinese Economy dominated by Hong Kong responds by exit and voice to the same demand and supply consideration once again. We can thus find that just as expansion of the U.S. federal law may be constrained by an international jurisdictional competition fuelled by cross-listing,³⁰⁵ the Taiwanese government's excessive regulation may be constrained by the jurisdictional competition fuelled by Taiwanese companies to list shares overseas. More importantly, both cases not just exemplify the operation of the law market for cross-listings, but also suggest "how jurisdictional competition could break out even

³⁰⁵ *Id.* at 122-39.

where the initial legal rules are not conducive to it—just as U.S. states ultimately came to apply the IAD to tramp corporations.”³⁰⁶

Finally, both of the U.S. and Taiwan stories regarding international listing markets seem far different from the state competition for corporate charters in the U.S. because they function “on the national level rather than within a federal system like the United States or Europe,” but their developments display that law market forces “similar to those operating on corporate law within federal systems are also operating on international securities laws.”³⁰⁷ In other words, these two stories imply that although somewhat disparate from corporate law markets under federalism in the U.S. and Europe, there are also general law market forces at work in the international context: The mobility of capital and talent enhanced by globalization serves as fuel to ignite and maintain the operation of international jurisdictional competition, which eventually leads to local legal changes. To conclude, the phenomena of the U.S. and Taiwan in listing markets tell with one accord that law market forces underlying international jurisdictional competition could provoke a change in excessive regulation to a more flexible regime. This assertion of jurisdictional competition would be further substantiated in the following macro-level analysis by elaborating on the relaxation transitions of the Capital Controls from 1997 to 2008.

B. The Output of Market Interactions in the International Jurisdictional Competition: Taiwan’s Regulatory Evolution from 1997 to 2008 on Outward Investment in Mainland China

³⁰⁶ O’HARA & RIBSTEIN, *supra* note 27, at 123.

³⁰⁷ Ribstein & O’Hara, *supra* note 8, at 710.

The Capital Controls has turned more flexible by now; however, the trajectories of the gradual relaxation of the Capital Controls appear to demonstrate how international jurisdictional competition would shape the regulatory evolution of such a democratically constrained onshore jurisdiction as Taiwan. Hence, this dissertation will, from a more macroscopic perspective, examine the function of the international jurisdictional competition among global legal centers, and tentatively argue that according to Taiwan's regulatory transitions law market forces underlying international jurisdictional competition nudge Taiwan's government to relieve the excessive regulation on outward investment in Mainland China and create a more flexible regime.

Part 1 begins with a detailed statement of why the amount of outward investment in Mainland China has been increasing substantially over time, and analyzes how and why the transition of Taiwan's Capital Controls is a trend towards liberalization stage by stage: from the NHBP policy in 1997, to "Proactive Liberalization with Effective Management" in 2001, to "Proactive Management and Effective Liberalization" in 2006, and to the wide-scope relaxation of the Capital Controls in 2008. It then points to the paradox that with the surge of investment in China the Capital Controls should have remained as strict or stricter to contain the outflows of capital and firms but the fact is just the opposite. Part 2 investigates the answer to this puzzle. It first makes clear the predicament in which the Capital Controls were landed that, disregarding business demands stimulated by globalization, Taiwan's government did try her best to regulate outward investment in China more effectively but failed after all. This displays how an onshore jurisdiction's regulatory capacity like Taiwan's is impaired by globalization generally and unfettered capital mobility in particular. Finally, this Taiwanese phenomenon demonstrates that,

under globalization, law market forces underlying international jurisdictional competition activated by business demands galvanize Taiwan's government into a quest for more legal flexibility, or the liberalization of the Capital Controls. To be sure, there might be alternative theories to account for the above Taiwan case. Part 3 thus addresses these.

1. The Puzzle of the Transitional Trajectories of the Capital Controls

1.1 The Upswing of Outward Investment in Mainland China

The historical development and recent trends of TDI in Mainland China could generally be illustrated by Figure 1. It was found that TDI has been attracted most to the other side of the Strait since 1990s for the following reasons.

First, as discussed above, Taipei decided in October 1987 to lift the ban on its citizens' visiting their relatives on the Mainland. Second, since 1987, Taiwan's government has become increasingly liberal about regulation of foreign exchanges and FDI outflows; therefore the capital mobility has been enhanced ever since,³⁰⁸ which will be further explained immediately below in Chapter 3.B.1.2.1. Third, TDI flowed substantially to China primarily because of huge market size and low production costs—low labor costs as well as cheap and abundant resources such as raw materials and land.³⁰⁹ For example, Natural Beauty, a franchise chain of cosmetics originating in

³⁰⁸ 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] (Taiwan), July 2003, at 54, 54.

³⁰⁹ According to a survey in 2002 by Investment Commission of MOEA on the motivations of Taiwanese firms' investment in Mainland China (the samples are collected in 2000), 76.18% of these China-based Taiwanese firms express that the main factor is the low production costs and the second incentive lies in its broad potential market. Ping-Jui Wu, *Da Po Tou Zi Zhong Guo De Mi Si* [Destroying the Myth of

Taiwan, has not only developed a huge market in China but also listed its shares in Hong Kong. It was low labor costs and strong demands in Chinese market that incentivized the franchise owner and founder to invest in China in the early 1992.³¹⁰ Fourth, “[g]rowing faster than the FDI from other countries, TDI in China has risen substantially since 1987 when the New Taiwan dollar started to appreciate against the U.S. dollar.”³¹¹ Fifth, “[c]ultural and linguistic affinity between Taiwan and China make it much easier for TDI to cross the strait than investments from industrial countries. In fact, linguistic and cultural affinities, and low labor and land costs, were recognized as the top motivations for most TDI in China.”³¹² Sixth, “[t]he geographic proximity . . . [has] led to Taiwanese firms’ preference for investing in China” as well.³¹³

What should also be noted is that the outward investment pattern continues as cross-Strait relations between China and Taiwan enter a new stage in which both China and Taiwan have been represented in the WTO since 2002, and the two countries’ economies are thus increasingly interdependent. Wang explains:

Investment in China], 27 TAIWAN JING JI YAN JIU YUE KAN [TAIWAN ECON. RES. MONTHLY] (ISSUE 8) 22, 24 (2004) (Taiwan). *See also* Peng-Fei Shen, *Quan Qiu Hua Qu Shi Xia Tai Shang Dao Da Lu Tou Zi Wen Ti Zhi Tan Tao—Yi Zi Jin Liu Dong Guan Dian Fen Xi* [Research on Issues of Taiwanese Firms’ Investment in Mainland China under Trends of Globalization: From a Perspective of Capital Flow], Address at Symposium of East Asian and Taiwan’s Economic Development in Cross-Strait Economy and Trade Research Center, Chihlee Institute of Technology, Taipei, Taiwan 1 (Nov. 9-18, 2005) (on file with author); Horng-Ming Tsai, *Taiwan Jing Mao Fa Zhan Dui Liang An Jing Mao Hu Dong Zhi Ying Xiang* [The Impact of Taiwan’s Economic Development on Cross-Strait Economic Interaction], 7 YUAN JING JI JIN HUI JI KAN [PROSPECT Q.] (ISSUE 2) 269 (2006) (Taiwan).

³¹⁰ Mao-Zhong Ma, *Tai Shang Fu Da Lu Tou Zi Jin Ru Mo Shi Yu Cheng Zhang Ce Lue Guan Xi Zhi Yan Jiu—Yi Zi Ran Mei Guo Ji Shi Ye Ji Tuan Lian Suo Jia Meng Wei Li* [The Relationship between Entry Modes and Growth Strategies in Mainland China for Taiwanese Companies—The Case Study on Natural Beauty Franchise Chain] 68 (June 2004) (unpublished master thesis, Da-Yeh University) (on file with author) (Taiwan).

³¹¹ Hou & Zhang, *supra* note 202, at 190.

³¹² *Id.* at 193.

³¹³ *Id.* at 194 (alteration in original).

Membership in the WTO opens China's economy further for foreign investors. China has promised to open telecommunications, banking and finance, insurance, commercial, and other service industries to foreign investors. It has allowed foreign investors to acquire business enterprises in China, besides setting up joint or cooperative ventures, and wholly owned enterprises. It has agreed to eliminate restrictions on markets, by allowing them to set up domestic sales outlets. It will lower tariffs and thus the costs of production, but the advantage of production for domestic sales would be decreased by competition from imports. The net effect of the further opening is to increase foreign investment. The composition will also change towards more of the service industries opened up under WTO membership.³¹⁴

For Taiwanese firms, the opening of new markets in the PRC as a consequence of WTO accession in 2002 indicates that the institutionalization of China's trade system can lower the uncertainty of the business environment, which thus increases medium- and large-sized Taiwanese firms' incentives for investment in China. Moreover, after both the PRC's and Taiwan's WTO accession, Taiwanese firms encounter higher international competition from other industrial countries, which pressures Taiwanese firms to invest more in China with a view to reducing production costs and expanding domestic market share.³¹⁵ In other words, upon China's accession to WTO, the wide opening up of the market and swift increase in domestic demand in China accelerated Taiwanese manufacturing enterprises' setting up factories while attracting Taiwanese service industries to capture the market.³¹⁶ Therefore, in light of Chinese official statistics, TDI

³¹⁴ 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* 265-66 (Dec. 2006) (unpublished S.J.D. dissertation, American University) (on file with author) (citation omitted).

³¹⁵ Horng-Ming Tsai, *Zhong Guo Da Lu Jia Ru WTO Hou Dui Tai Shang Tou Zi Zhi Ying Xiang—Jian Lun Wo Zheng Fu Zhi Zheng Ce Tiao Zheng* [*The Impact of China's Accession to WTO on the Taiwan Investors and the Adjustments of Government Policy*], 3 YUAN JING JI JIN HUI JI KAN [PROSPECT Q.] (ISSUE 3) 161, 161, 201 (2002) (Taiwan).

³¹⁶ Joseph Jaushieh Wu, Chairperson, Mainland Affairs Council, Executive Yuan, *Liang An Jing Mao Guan Xi Ji Tou Zi Li Ji Fen Xi* [*The Analysis of Cross-Strait Economic Relations and the Investment Niche*], Address at the 25th World Chinese Traders Convention 12 (Oct. 4, 2006) (slides available at:

in China has been increasing more, at least apparently since 2000 thanks to the above WTO factor.³¹⁷

Taking it by and large, above the rise in Taiwan's labor costs and labor shortages, as Hou and Zhang point out,

[t]he TDI boom in China is the result of an intimate interaction between Taiwanese push force and Chinese pull gravity. This is a typical story of conventional comparative advantages plus cultural and linguistic affinity across the Taiwan Strait. On the one hand, China is at a lower stage of development, with abundant cheap labor, vast amounts of land, and raw materials, which are attractive to foreign investors. On the other hand, Taiwan has already industrialized, with sophisticated technology and a well-established international marketing network, but seeking industry upgrading because of changing international comparative advantages and continued growth. Such 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.³¹⁸

In a word, the relative stages of development between the Taiwanese and Chinese economies plus the international division of labor under economic globalization have led to Taiwanese firms' preference for investing in China. Meanwhile, the entry into WTO in 2002 of both China and Taiwan speeds the more obvious rise of TDI in China, in particular demonstrated by the changing nature of TDI industries from labor-intensive small firms to capital-technology-intensive large conglomerates.³¹⁹

<http://wetc25.taiwantrade.com.tw/20061004-1340-1.ppt>.

³¹⁷ CHARNG KAO, DA LU JING GAI YU LIANG AN JING MAO [CHINA'S ECONOMIC REFORM AND CROSS-STRAIT ECONOMIC RELATIONS] 199 (2008) (Taiwan).

³¹⁸ Hou & Zhang, *supra* note 202, at 200-01. *See also* Chang & Goldstein, *supra* note 190, at 21-22.

³¹⁹ Hou & Zhang, *supra* note 202, at 197.

1.2 The Transitions of the Capital Controls

1.2.1 Before the Imposition of the Capital Controls: A Perspective on Changes in the Macroeconomic Context

As noted above, since the late 1980s, Taiwan's government has gradually lightened the regulation of foreign exchanges and FDI outflows so that the mobility of Taiwanese capital and firms has been increased since then. This is one of the significant reasons responsible for the fact that TDI were flocking to the other side of the Strait from the 1990s. In effect, changes in the macroeconomic context could be the underlying factor pushing this phenomenon through, and even presage the gradual collapse of the Capital Controls. First of all, as Dignam and Galanis discuss,

the traumatic experiences of the Great Depression and WWII gave rise to a consensus for the establishment of a stable international macroeconomic system, along Keynesian interventionist lines, which would provide the foundations for the reconstruction of devastated economies worldwide. In 1944, a conference at Bretton Woods in the United States, gave rise to a global system of currency exchange whereby all currencies were fixed to the US dollar and restrictions on the movement of capital across borders were put in place.³²⁰

Further, “[a] key element in the stability achieved by the Bretton Woods Agreement was *the restriction on capital mobility across borders*, which allowed national authorities sufficient financial autonomy to pursue full employment and welfare state policies designed to maintain sufficient levels of effective demand.”³²¹ Put it somewhat differently, it was not easy for Bretton Woods-style fixed exchange rates to be maintained

³²⁰ Dignam & Galanis, *supra* note 171, at 211.

³²¹ *Id.* at 213-14 (emphasis added).

in an open economy, and there should thus be some type of the restrictions on cross-border capital mobility.

Nonetheless, “changes in key independent elements of the macroeconomy [led] up to . . . the collapse of the Bretton Woods Agreement”³²² It merits quoting Eichengreen’s explanation at some length:

Pegged rates were viable for the first quarter-century after World War II, the argument goes, because of the limited mobility of financial capital, and the subsequent shift to floating rates was an inevitable consequence of increasing capital flows. Under the Bretton Woods System that prevailed from 1945 through 1971, controls loosened the constraints on policy. They allowed policymakers to pursue domestic goals without destabilizing the exchange rate. They provided the breathing space needed to organize orderly exchange rate changes. But the effectiveness of controls was eroded by the postwar reconstruction of the international economy and the development of new markets and trading technologies. The growth of highly liquid international financial markets in which the scale of transactions dwarfed official international reserves made it all but impossible to carry out orderly adjustments of currency pegs. Not only could discussion before the fact excite the markets and provoke unmanageable capital flows, but the act of devaluation, following obligatory denials, could damage the authorities’ reputation for defending the peg. Thus, at the same time that pegged exchange rates became more costly to maintain, they became more difficult to adjust. The shift to floating was the inevitable consequence.³²³

In the Taiwan case, from the end of World War II to July 10, 1978, Taiwan adopted a fixed exchange rate system. In line with macroeconomic changes as explained above,

³²² *Id.* at 216.

³²³ BARRY EICHENGREEN, *GLOBALIZING CAPITAL: A HISTORY OF THE INTERNATIONAL MONETARY SYSTEM* 1-2 (1998).

since July 11, 1978, Taiwan has changed to a managed floating exchange rate system.³²⁴

As Dignam and Galanis elaborate,

[t]he collapse of the Bretton Woods fixed exchange-rate system between 1971 and 1973 signalled the beginning of a new era for the inter-national economic order, in which currencies floated free and capital controls were removed. As Eatwell noted, when governments and Bretton Woods agencies stopped bearing the full costs of currency management with the imposition of capital controls, foreign exchange risk was privatized. Floating exchange rates not only created vast profit opportunities for currency speculators, but also made hedging against volatility risks a necessity for both financial and non-financial corporations. In order to deal with these new private demands, governments *removed exchange controls and financial regulations that restricted capital flows*. Relatively quickly, the majority of transactions in the newly emerged global financial markets turned from financing trade or production to capturing gains from speculative predictions about currency movements.³²⁵

Accordingly, in order to stay in harmony with the implementation of the floating rates and to establish foreign exchange markets, Taiwan has progressively relaxed controls on foreign exchange since 1979. In July 1987, Taiwan took major measures to liberalize foreign exchange, thus removing most exchange controls and financial regulations that restricted capital flows.³²⁶ Subsequently, Taiwan in 1989 modified laws on outward investment on a large scale, which may contribute to the considerable upsurge of investment in foreign areas (including Mainland China) from then on.³²⁷ Just as Dignam and Galanis note,

³²⁴ 2 CHING-HSI CHANG ET AL., *JING JI XUE—LI LUN YU SHI JI* [ECONOMICS—THEORY & PRACTICE] 338-39 (3rd ed. 1995) (Taiwan).

³²⁵ Dignam & Galanis, *supra* note 171, at 216-17 (footnote omitted) (emphasis added).

³²⁶ CHANG ET AL., *supra* note 324, at 340-41.

³²⁷ Huilin Wu, *Lun Ti Shang Ru He Yin Ying Liang An Jing Mao De Yan Hua* [On How Taiwanese Businesses Respond to the Evolution of Cross-Strait Economic Relations], 34 *JIAN HUA JIN RONG JI KAN* [SINO-PAC FINANCIAL JOURNAL-QUARTERLY] 1, 6 (2006) (Taiwan).

with unfettered capital mobility, cost-driven foreign direct investment (FDI) flows can be directed from the developed world to countries where inputs, mainly labour, are available at a low comparative cost. Thus, less developed countries with low labour costs in terms of wages and employment protection enjoy significant locational advantages over those countries where wages are high and redundancies are costly.³²⁸

Therefore, since the end of 1980s, with the lifting of limits on foreign exchange in the first instance, Taiwanese firms from the more developed world has been making more and more investment on the Mainland as China's low labor costs and potential markets held a special attraction for them.³²⁹ In other words, the macroeconomic changes lifted bans on the mobility of Taiwanese capital; with remarkably lowered exit costs, the aggrandized capital mobility subsequently gave rise to Taiwanese firms' progressively investing overseas, especially in Mainland China.

In theory, pursuant to the macroeconomic tendency as stated above, Taiwan would have not laid down more limits on capital mobility so as to let the invisible hand operate more freely, or to let economic activity in the private sector prosper itself. As Chen and Chu observe, prior to the imposition of the Capital Controls in 1997, "[f]or most Taiwanese investors, it's only natural . . . to move their sunset industries to mainland China where they can rejuvenate their declining competitiveness. But Taiwan government's idea is somewhat different."³³⁰ That is, in practice, 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 as

³²⁸ Dignam & Galanis, *supra* note 171, at 237 (footnote omitted).

³²⁹ Chen-Yuan Tung, *Liang An Jing Ji Quan Qiu Fen Gong Yu Hu Lai* [*Cross-Strait Economic Relations in View of Global Division of Labor and Interdependence*], 7 JING JI QING SHI JI PING LUN [ECON. SITUATION & COMMENT.] (ISSUE 3) 116, 119 (2001) (Taiwan).

³³⁰ Chen & Chu, *supra* note 182, at 220.

highlighted in Chapter 3.B.3.3-4, mainly prompted former President Ten-Hui Lee in September 1996 to announce the NHBP policy.³³¹ Nevertheless, as explicated below in Chapter 3.B.2, facing up to the non-economic concerns such as national security, business demands for more intense investment in China put enormous pressures on the ability of Taiwan's government to maintain the strictness of the Capital Controls. In effect, the notable increase of cross-border capital mobility, following changes in the macroeconomic context, presages the conundrum that the systemic fortress and legitimate reason for keeping up the Capital Controls would be gradually demolished.

1.2.2 The “No Haste, Be Patient” Policy (1997-2001)

Taiwan, in July 1997, amended and implemented related restrictions on investment in Mainland China. However, as Sutter argues, “[g]overnment restrictions and political tensions” have significantly hampered business activities.³³² According to the Principles amended on July 15, 1997, Taiwan's government, until adopting the PLEM policy in 2001, 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. MOEA classified potential investments in China as permitted, prohibited, and “special

³³¹ Sutter, *supra* note 184, at 525. See also Zhen-Yin Jiang, *Yin Ying Jing Ji Quan Qiu Hua Zhi Liang An Jing Mao Guan Xi [Handling Cross-Strait Economic Relations under Globalization]*, 26 TAIWAN JING JI YAN JIU YUE KAN [TAIWAN ECON. RES. MONTHLY] (ISSUE 1) 50, 51 (2003) (Taiwan).

³³² Sutter, *supra* note 200, at 29.

case.” Permitted projects were of industries where Taiwan is 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 6, Taiwan also imposed a general system to limit Taiwanese firms’ investments in the PRC according to their overall financial exposure and ownership structure.

In sum, the NHBP policy has been 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.”³³³

1.2.3 The “Proactive Liberalization with Effective Management” Policy (2001-2005)

Why was there a regulatory transition from NHBP to PLEM in 2001? Yang and Hung find:

While past efforts [of the NHBP policy] to restrain investment were designed to prevent China from gaining an economic or technological advantage over Taiwan, the following factors have forced the government in Taipei to rethink its strategy: a

³³³ Chen & Chu, *supra* note 182, at 220. *See also* Yang & Hung, *supra* note 199, at 682 (“There is a fear that the Taiwanese manufacturing sector could be swallowed up by China”).

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.³³⁴

What's more, as Chen further notes, "[in] spite of Taiwan's official restrictions on bilateral trade and investment, China has become an important trading partner and an important investment destination for Taiwan. The entry into WTO by China and Taiwan would eliminate some of these restrictions, returning the bilateral trade relationship to normalcy."³³⁵ In fact, Taiwan entered into the WTO on January 1, 2002, which date is not long after the regulatory transition from NHBP to PLEM was carried through. It is obvious that this transition is considerably relevant to Taiwan's efforts for accession to the WTO.³³⁶ Moreover, subsequent to both the PRC's and Taiwan's WTO accession, Taiwanese firms confronted more intense international competition from other industrial countries, which forced these firms to inevitably invest more in China so as to further lower production costs and to expand more market share on the Mainland.³³⁷

From the general perspective of international division of labor under economic globalization, Sutter argues:

Growing cross-Strait investment and trade is also driven in part by changing patterns in East Asia. The 1990s saw large inflows of foreign investment and cross-border

³³⁴ *Id.*

³³⁵ 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 (Ipppei Yamazawa & Kenichi Imai eds., 2001).

³³⁶ 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 2006) (unpublished master thesis, National Taiwan University) (on file with author) (Taiwan).

³³⁷ See Xie, *supra* note 308.

specialization, especially in intermediate goods. China quickly became a base for more technology-intensive industries such as machinery and electronics, thanks to its lower trade barriers and labor costs. Upon China's WTO entry barriers would fall even further, allowing for even more cross-border specialization and interdependence in manufacturing trade in areas such as chemicals, steel, and IT. For example, as signatories to the Information Technology Agreement, PRC and Taiwan must lower tariffs on most IT imports to zero over a five-year period.³³⁸

In light of comparative advantages plus cultural and linguistic affinity across the Strait as well as economic complementarities, Taiwanese firms kept voicing their petition for the liberalization of the NHBP policy in order to maintain their value in the global production chain.³³⁹

To be sure, “[t]here is 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].”³⁴⁰ Despite this concern, “as the PRC liberalizes investment opportunities in the very sectors that remain regulated by Taipei, many firms are skirting domestic ceilings.”³⁴¹ In order not to lose control over dramatic and explosive cross-Strait trade and investment, Taiwan's government cannot but try to maintain realistic policies. 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 first term of presidency,

³³⁸ Sutter, *supra* note 200, at 30.

³³⁹ 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).

³⁴⁰ Sutter, *supra* note 184, at 534 (alteration in original).

³⁴¹ *Id.* at 535.

“regained some momentum with the formation and meeting of the Economic Development Advisory Council in [August] 2001.”³⁴² 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.”³⁴³ The EDAC statements “offer an important source of support and legitimacy that allow Chen’s administration to pursue liberalization.”³⁴⁴ This is the first-stage relaxation of the Capital Controls from 1997 to 2008.

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 Executive Yuan (equivalent to U.S. Department of State) 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 is also relaxed as exhibited in Table 7.

In sum, as Chang and Goldstein point out,

³⁴² Sutter, *supra* note 200, at 32 (alteration in original).

³⁴³ *Id.*

³⁴⁴ Sutter, *supra* note 184, at 532.

[i]n 2001, on the eve of accession to the WTO, the administration of [Shui-Bian Chen] 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* on the eve of the legislative elections. In essence, the rules that followed from the new approach retained the principle of government regulation of investments and imports, and [maintained] the “security coefficient of the economy” [(“Effective Management”)], while simplifying administrative procedures and easing restrictions on the size of investments (for example, the US\$50 million cap on investment size was eliminated) and on the types of projects that could be initiated [(“Proactive Liberalization”)].³⁴⁵

1.2.4 The “Proactive Management with Effective Liberalization” Policy (2006- Apr. 2008)

On January 1, 2006, President Shui-Bian Chen in the public speech of New Year’s Message advocated a “new idea and method” concerning cross-Strait economic and trade policies. He asserted that the consensus of the PLEM policy reached by EDAC in August 2001 would be replaced by the “Proactive Management with Effective Liberalization” policy (the “PMEL” policy). According to the Mainland Affairs Council (“MAC”), the primary aim of this new 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.³⁴⁶ Three factors play key roles in this regulatory transition from PLEM to PMEL. First, as Wang notes,

³⁴⁵ Chang & Goldstein, *supra* note 190, at 35 (alteration in original) (emphasis added).

³⁴⁶ KAO, *supra* note 317, at 158.

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 using military force toward Chinese unification to a legal perspective.³⁴⁷

Second, Taiwan's economy has been 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 intended to maintain Taiwan's 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.³⁴⁸

Specifically, 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 amended on December 25, 2006, on top of existing case-by-case approval by MOEA, under each of the following three circumstances a Policy Review should be conducted towards applications of prior approval for investments in China: First, the amount of an individual investment made by individuals, legal persons and organizations in Taiwan exceeds \$100 million; second, the amount of accumulated investments exceeds \$200 million while the amount of capital-increase for each time exceeds \$60 million; third, investments involve core industrial technology. Under the Policy Review, Taiwanese

³⁴⁷ Wang, *supra* note 314, at 82 (alteration in original).

³⁴⁸ Weng, *supra* note 339, at 93-94.

firms' CEOs would be interviewed by a panel consisting of the personnel from all authorities concerned in order to request these firms' concrete commitment regarding financial plans, technology transfers, exported equipment, and mutual investment and employment in Taiwan. These firms should further commit themselves to assenting to on-site investigation on factories located in China by professionals delegated by MOEA.

The main difference between the PMEL policy introduced in 2006 and the PLEM policy launched in 2001 is that the former focuses on enhancement of the "security coefficient of the economy" ("Effective Management") of the PLEM policy. Basically, there are no other crucial differences between these two policies³⁴⁹ as, for instance, the general system to limit Taiwanese firms' investments in the PRC according to their overall investment exposure and ownership structure remains unchanged. But most people think that the PMEL policy adds another layer of controls over Taiwanese firms' investment in China in comparison with the former PLEM policy.³⁵⁰ On top of legislators from KMT (the then opposition and current ruling party which took anti-regulatory position), many people even including legislators from DPP, the then ruling and current opposition party which took pro-regulatory stance, also opposed the re-tightened PMEL policy, arguing that the Policy Review would expedite physical exit of Taiwanese firms and capital.³⁵¹ Replying to foreign journalists' inquiry of whether the

³⁴⁹ See Li, *supra* note 336, at 143.

³⁵⁰ See, e.g., Weng, *supra* note 339, at 2, 87 & 89; *Tai Dang Ju Zai Du Jin Suo Da Lu Tou Zi Zheng Ce* [Taiwan's Government Re-tightens the Regulation on Investment in Mainland China], HUA XIA JING WEI WANG [HUAXIA NETWORK] (P.R.C.), Mar. 28, 2006, <http://big5.huaxia.com/tslj/rdgc/2006/03/71460.html> (last visited Oct. 6, 2008); *Zhe Shi Xing Zheng Qian Zhi Bu Shi Ji Ji Quan Li* [This Is Perverse Administrative Intervention, Not Proactive Management], XING DAO HUAN QIU WANG [SING TAO GLOBAL NETWORK] (Sing.), Mar. 24, 2006, http://www.singtaonet.com/op_ed/taiwan_forum/t20060324_173080.html (last visited Oct. 6, 2008) (quoting the editorial of China Times in Taiwan).

³⁵¹ *Tou Zi Da Lu Zeng Zheng Ce Shen Cha Lü Wei Pi: Zhe Yang Gao Xia Qu Si Ding Le* [The Policy Review Is Imposed on Investment in Mainland China; legislator from the Ruling Party: Taiwan's Economy

PMEL policy was against the trend of globalization, then Vice Premier and current DPP Chairperson Ing-Wen Tsai admitted at that time that Taiwan's unilateral regulation was neither the best nor the only way to resolve the problem of Taiwan's economical over-dependence on China, and that this new policy could merely delay Taiwanese firms' further investment in the PRC but was unable to effectively block up these firms' paths towards Mainland China.³⁵² In response to this transition towards probable more regulation, China-based Taiwanese firms not only continued voicing their petition for more liberalization of cross-strait economic and trade policies,³⁵³ but also kept exiting from Taiwan's stock markets by listing shares abroad and transferring their capital located in Taiwan through "underground" or illegal routes towards China, in order to evade the Capital Controls and Constraints.³⁵⁴

Meets Its Doom], XING DAO HUAN QIU WANG [SING TAO GLOBAL NETWORK] (Sing.), Mar. 24, 2006, http://www.singtaonet.com/global/taiwan/t20060324_173120.html (last visited Oct. 6, 2008).

³⁵² *Ing-Wen Tsai: Liang An Jing Mao "You Xiao Kai Fang" Zheng Ce Shu Yue Nei Xian Pai [Ing-Wen Tsai: "Effective Liberalization" Policy of Cross-Strait Economic Relations Will Be Announced in Several Months]*, XING DAO HUAN QIU WANG [SING TAO GLOBAL NETWORK] (Sing.), Mar. 28, 2006, http://www.stnn.cc:82/global/taiwan/t20060328_176379.html (last visited Oct. 6, 2008). Similarly, Tung argues that the NHBP policy initiated by the Lee administration in 1997 did not effectively impose too many constraints on Taiwan-invested firms' actual investment in China, and that these firms even expedited shifting their production bases towards China, thus successfully strengthening their global competitiveness by taking good advantage of the edge of linguistic affinities and geographic proximity. CHEN-YUAN TUNG, DONG YA JING JI ZHENG HE YU TAIWAN DE ZHAN LÜE [THE EAST ASIAN ECONOMIC INTEGRATION REGIME AND TAIWAN'S STRATEGY] 374 (2009) (Taiwan); also Tung, *supra* note 266, at 16.

³⁵³ Weng, *supra* note 339, at 75.

³⁵⁴ *Ji Ji Guan Li Pei Tao Ji Zhi Chu Tai Da Lu Tai Shang: Wei Shi Yi Wan [Supportive Tools of Proactive Management Are Ready; Taiwanese Business Community: It's Too Late]*, XING DAO HUAN QIU WANG [SING TAO GLOBAL NETWORK] (Sing.), Mar. 23, 2006, http://www.singtaonet.com/global/taiwan/t20060323_172185.html (last visited Oct. 6, 2008); Zhen-Ling Peng, Op-Ed., *Ji Ji Quan Li Fan Xiao Guo Bi Taiwan Ben Tu Qi Ye Lian Gen Chu Zou [Adverse Effect of the Policy of Proactive Management with Effective Liberalization: Forcing Taiwanese Local Enterprises to Totally Exit]*, XING DAO HUAN QIU WANG [SING TAO GLOBAL NETWORK] (Sing.), Mar. 23, 2006, http://www.singtaonet.com/global/taiwan/t20060323_172042.html (last visited Oct. 6, 2008); *Tou Zi Da Lu Ji Ji Guan Li Ye Jie: Xian Zhi Yue Duo Di Xia Guan Dao Yue Wang [Investments in Mainland China Will be Proactively Managed; Business Community: The More Restrictions, the More Investments Are Driven Underground]*, XING DAO HUAN QIU WANG [SING TAO GLOBAL NETWORK] (Sing.), Mar. 24, 2006, http://www.singtaonet.com/global/taiwan/t20060324_173174.html (last visited Oct. 6, 2008).

1.2.5 Large-Scale Liberalization since May 2008

As elaborated above in Chapter 3.A.2.2, torrential outflows of Taiwanese capital and firms pressured Taiwan's government to deliberate turning to a more laissez-faire regulation. Such policy direction was then confirmed by promises from both candidates in Taiwan's presidential election concluded in March 2008.³⁵⁵ In light of Taiwan's plight of sluggish economy, both presidential candidates from KMT and DPP at that time maintained prospective relaxation of the Capital Controls.³⁵⁶ The current KMT 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 eased the PMEL policy to a tremendous degree. 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 is canceled. Second,

³⁵⁵ Bradsher reports:

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, *supra* note 2.

³⁵⁶ Mr. Ma, the candidate from the current ruling party KMT and the new president-elect, supported the relaxation of the Capital Controls by a wide margin. *See, e.g.*, Taiwan International Securities Investment Consulting Corp., *A Breakout Bull Market for Taiwan's Bourse* (May 2007), <http://www.tisc.com.tw/new/newreport/special/upload/special20070525-1.pdf> (last visited Sep. 22, 2007) (Taiwan). On the other hand, Mr. Hsieh, the candidate from the former ruling and current opposition party DPP, also turned to the partially loosening of the Capital Controls under specific circumstances. *See, e.g.*, *Hsieh Chang-Ting Zhu Zhang Kai Fang Zhong Guo Da Lu Zi Jin Lai Tai* [Frank Hsieh Claims Allowing the Entry of Mainland Capital into Taiwan], ZHONG GUANG XIN WEN WANG [BCC NEWS NETWORK] (Taiwan), Oct. 18, 2007, <http://news.pchome.com.tw/crossstrait/bcc/20071018/fpt-20071018183607210145.html> (last visited Mar. 28, 2008).

investments in China less than \$1 million may 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 8.

1.3 The Paradox between the Surge of Investment in China and the Relaxation of the Capital Controls

As Figure 1 displays, we can see that TDI in China has been increasing significantly over time (from \$1.61454 billion in 1997 to \$9.97055 billion in 2007). In effect, the Capital Controls had been designed to stem the tide of TDI in China, so that Taiwan's government should have maintained or lowered caps of TDI in China while enforcing the Capital Controls more and more stringently, like the transition from the PLEM policy in 2001 to the PMEL policy in 2006, which in my definition indicates that "Investment Allowance" should have been at least maintained or further decreased over time. Nonetheless, if using caps on Taiwanese individuals' accumulated amount of investments in China from the NHBP policy (NT\$60 million), to the PLEM policy (NT\$80 million), to the PMEL (NT\$80 million), and to large-scale liberalization in 2008 (\$5 million or around NT\$168 million) as a proxy for Investment Allowance, we can find a paradox that the Capital Controls are relaxed in 2001 and the range of relaxation in 2008 after

President Ma took power is distinctly wide especially in the cases that the investment upper limit of a Taiwanese corporation establishing its headquarter in Taiwan or of a multinational enterprise's Taiwanese subsidiary is wholly lifted.

Therefore, questions arise: Why did both TDI in China and Investment Allowance move in a rising way as shown in Figure 2? What would be the causation between these two curves? In my opinion, the regulatory transition of the Capital Controls from 1997 to 2008 could appropriately illustrate how international jurisdictional competition provoked by business demands of Taiwanese firms and their attending firm or capital mobility under globalization shaped the easing trend of China-investment regulation by Taiwan's government. To be concrete, I would tentatively argue that business demands, via exit and voice rights (or law market forces underlying international jurisdictional competition), spurred stage-by-stage relaxation of Taiwan's Capital Controls. The international jurisdictional competition, which were stimulated by these business demands and fuelled by accompanying firm mobility, pushed such a democratically constrained onshore jurisdiction as Taiwan to relieve its excessive 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.³⁵⁷ In another word, 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

³⁵⁷ See Dignam & Galanis, *supra* note 171, 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").

financial capital) turns the Capital Controls ineffective, as explained below, contribute to the stage-by-stage liberalization.

2. Law Market Forces Also at Work: The Stage-by-Stage Relaxation Nudged by International Jurisdictional Competition

2.1 Onshore Jurisdictions' Regulatory Capacity Impaired by Globalization

2.1.1 Circumvention via Offshore Financial Centers

In the light of China's statistics, from mid-1990s TDI remains the second largest FDI in the PRC. But from 1999 TDI falls to the fourth largest while OFCs in British Central America such as BVI become the second largest FDI inflows in China. As shown in Table 4 and the attending discussion in Part A.1.2.2.2 of this chapter, at least since 1994 OFCs in British Central America have been priorities for destinations of Taiwan's outward investment aside from Mainland China. A study displays that Taiwanese firms transit their funds to these OFCs for later investments in China whereas these funds are not exhibited in China's statistics of TDI.³⁵⁸ In other words, China's statistics

³⁵⁸ David Ming Wei, *Tai Shang Yu Tai Shang Zheng Ce: Da Zao Liang An Guan Xi De Suo Yue* [*Taiwanese Businessmen in China: Key to Cross-Strait Relationship*], 460 DONG YA LUN TAN JI KAN [E. ASIA REV.] 37, 42-43 (2008) (Taiwan). See also Shao-Yun Fang, *Jing Wai Gong Si Ji Tuan Chong Zu De Yun Zuo* [*How the Restructuring of Offshore Corporate Groups Works*], SHI YONG YUE KAN [TAXES & BUS. MONTHLY SERVICES], Apr. 2002, at 54 (Taiwan); Shao-Yun Fang, *Xuan Yong Wei Jing Dao Gong Si Zuo Da Lu Tou Zi Kong Gu Gong Si De Zai Kao Liang* [*Reconsidering Whether to Adopt BVI Corporations as Holding Corporations for Investment in Mainland China*], SHI YONG YUE KAN [TAXES & BUS. MONTHLY SERVICES], June 2002, at 57 (Taiwan) (arguing that Taiwanese firms indirectly invest in China by incorporating investment-holding corporations in BVI in order to evade the Capital Controls); Zi-Ping Huang, *Cong Guan Xi Ren Jiao Yi Ji Cai Wu Bao Biao Xiang Mu Deng Gong Kai Zi Xun Tan Tao Tai Shang Jin Xing Da Lu Tou Zi Zhi Cai Wu Zi Xun* [Research on Financial Information on Taiwanese Businesses' Investment in Mainland China in Light of Public Information such as Related Party Transactions and Items on Financial Statements], at I (June 2002) (unpublished master thesis, National Cheng Kung University) (on file with author) (arguing that Taiwanese firms indirectly invest in the PRC by incorporating holding companies in a third area such as BVI, Hong Kong, Singapore, and the Cayman

underestimate the real amount of TDI in China. From mid-1990s, due to the imposition of the NHBP policy, many Taiwanese firms remitted capital to holding corporations incorporated in OFCs for later indirect investment in Mainland China. As exhibited in Table 9, there is a coincidence between the increase of Taiwan's investment in BVI and that of BVI's investment in China in the second half of the 1990s. Taiwan's investment in OFCs in British Central America increased from 15% of Taiwan's total outward investment in 1995 to 30% in 1999; this doubling made British Central America the second largest destination for Taiwan's outward investment. From China's perspective, BVI's outward investment in China increased from 0.8% of China's total FDI inflows in 1995 to 6.6% in 1999; this growing rendered BVI surpass Japan in terms of FDI inflows to China, thus turning into the third largest FDI source only second to Hong Kong and the United States.³⁵⁹ Further, some might wonder why the differences of numbers of cases in Taiwan's and China's statistics in Table 2 falls over time from a factor approximately 10 to less. The above evidence, to a degree, could account for this change. To be concrete, since the imposition of the Capital Controls in 1997, more and more Taiwanese firms have transformed their channel of investment in China: from direct investment approved by MOEA and identified by Chinese officials as TDI to indirect investment through

Islands); Wang, *supra* note 314, at 266 (arguing that in spite of the government's restrictions trade and investment between Taiwan and Mainland China have existed by flowing through Hong Kong and other avenues); JUNG-PAO KANG ET AL., WO QUO QI YE FU HAI WAI MU JI ZI JIN AN JIAN ZHI FA XING TIAO JIAN JI QI FA XING JIA GE HE LI XING ZHI YAN JIU [RESEARCH ON THE REASONABILITY REGARDING IPO CONDITIONS AND PRICE OF TAIWANESE FIRMS RAISING CAPITAL OVERSEAS] 2 (2004) (on file with author) (Taiwan) (arguing that restrictions on capital flow and caps on investment in Mainland China are among the reasons why Taiwanese firms invest in the PRC, usually through a third country); Te-Shen Chen, *Jing Ji Quan Qiu Hua Yu Tai Shang Da Lu Tou Zi: Ce Lue Yu Bu Ju* [Economic Globalization and Taiwan's Investment Strategies in China], in JING JI QUAN QIU HUA YU TAI SHANG DA LU TOU ZI: CE LUE BU JU YU BI JIAO [ECONOMIC GLOBALIZATION AND TAIWAN'S INVESTMENT STRATEGIES IN CHINA] 127, 139 (Te-Sheng Chen ed., 2008) (Taiwan) (explaining that as demonstrated in Table 4 most of Taiwan's investments in British Central America and Hong Kong are transited for investments in China).

³⁵⁹ CHEN-YUAN TUNG, QUAN QIU HUA XIA DE LIANG AN JING JI GUAN XI [CROSS-STRAIT ECONOMIC RELATIONS IN THE ERA OF GLOBALIZATION] 25-26 (2003) (Taiwan).

OFCs to successfully avoid the Capital Controls but identified by Chinese Officials as FDI from British Central America. As the number of projects identified by China as TDI decreases, the factor turns out to be less.

According to a couple of 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 their subsidiaries incorporated in the Cayman Islands, Bermuda and BVI as holding companies.³⁶⁰ In accordance with another study by Chen-Yuan Tung who surveyed several China-based Taiwanese firms, a former chairman of Taiwan's chamber of commerce in Shanghai expressed that most of the funds transferred from BVI to Mainland China were Taiwanese capital and that outside of Taiwanese firms there was relatively little need for Japanese, European, or American firms to transfer funds to BVI first and then employ these funds for investment in China. Other Taiwanese firms surveyed also indicated that many Taiwanese firms including themselves invested in Mainland China via holding companies incorporated in BVI, the Cayman Islands, or Bermuda.³⁶¹ The above result of Tung's study is further corroborated by the following evidence. In the light of statistics collected by PRC's Ministry of Commerce in 2002, 78% of FDI inflows to China from BVI and the Cayman Islands were funds indirectly invested by Taiwanese firms; Chinese estimation in 2004 demonstrated that around 70% of FDI inflows to China from the above two OFCs were Taiwanese capital. Dan-Yang Shen, a senior research fellow and official in PRC's Ministry of Commerce, also asserted that about two-thirds of funds invested in China from OFCs like BVI were originally

³⁶⁰ *Id.* at 26.

³⁶¹ Tung, *supra* note 329, at 120-21.

derived from Taiwanese businesspeople.³⁶²

2.1.2 The Role of Offshore Financial Centers in International Jurisdictional Competition

As discussed above, Taiwanese entrepreneurs have increasingly been incorporating in Hong Kong or other OFCs like the Cayman Islands and BVI in order to bypass the Capital Controls. In other words, Taiwanese firms have tackled the Capital Controls by structuring abroad in OFCs such as BVI.³⁶³ Obviously, OFCs play an important role here. As we know, with increasing globalization, many firms are directly registering in OFCs such as Bermuda, BVI or the Cayman Islands; more and more multinationals are setting up their affiliates in OFCs, while other firms are transferring their headquarters to OFCs. One of the significant reasons is that secrecy policies are a specific feature of most

³⁶² Hung & Tung, *supra* note 293, at 6. Sutter presented a similar report:

By the end of 2000 . . . [TDI in China] is likely to be as high as \$70 billion - 100 billion, in view of investments by Taiwanese firms via offshore companies in Hong Kong and [other OFCs], which is not typically calculated as [TDI in China] in either PRC or Taiwan statistics. When these indirect investments are included, an estimated 50% of Taiwan's outbound FDI is now invested in the PRC. According to Taiwan's MOEA, by the end of 2000 almost three-quarters of Taiwanese firms that had invested overseas had investments in the PRC.

Sutter, *supra* note 184, at 528-29 (alteration in original) (footnote omitted). Specifically, "[w]hen one calculates for [Taiwan's] indirect investment in China, a large percentage of the 20.86% that MOEA indicated went to 'tax havens in British Central America' and [of] the 2.55% that went to Hong Kong in fact went [altogether] onward towards PRC investments [as the final destination]." *Id.* at 529 (alteration in original). As Sutter adds, in around 2002,

as investment has shifted to electronics and IT production, [Taiwanese] investment has increased dramatically in and around Shanghai. According to the MOEA, between 1997 and 2000 electronics jumped from 20% to 60% of all approved [Taiwanese] investment in the PRC. The real figure is likely even higher considering the many IT investments that were structured offshore during this period.

Id. at 530 (alteration in original) (footnote omitted).

³⁶³ *Id.* at 527.

OFCs,³⁶⁴ particularly in relation to both the beneficial ownership of offshore companies and to offshore bank accounts. For instance, “the Cayman Islands adopted a statute providing exceptionally strong financial privacy protections, expanding on what was available under the applicable English common law by adding criminal sanctions for violations.”³⁶⁵ Also, “financial entities in the Cayman Islands are well-protected against leaks of confidential information accumulated in the course of investigations by the Confidential Relationships (Preservation) Law.”³⁶⁶ On BVI, the secrecy of BVI International Business Companies is highly preserved. 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’s courts are allowed to review stock ledgers. Therefore, in general, the public cannot know which companies have something to do with investment in Mainland China.³⁶⁷ 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.”³⁶⁸ According to HKSE’s

³⁶⁴ Art Durnev et al., *The Governance of Offshore Firms: Implications for Financial Reporting* 2-3, 8-9 (Apr. 18, 2009), available at <http://ssrn.com/abstract=1325895>.

³⁶⁵ Andrew P. Morriss, *The Role of Offshore Financial Centers in Regulatory Competition* 48 (University of Illinois Law & Econ. Research Paper No. LE07-032, 2008), available at <http://ssrn.com/abstract=1275390>.

³⁶⁶ *Id.* at 50.

³⁶⁷ 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).

³⁶⁸ Hong Kong Exchanges and Clearing Limited, *Joint Policy Statement Regarding the Listing of Overseas Companies* (Mar. 2007), <http://www.hkex.com.hk/news/hkexnews/070307news.htm> (last visited Mar. 7, 2009) (H.K.) (alteration in original).

statistics by Mar. 2, 2006, among 48 Taiwan-invested firms once or then listing shares on HKSE, 14 of them are incorporated on Bermuda, one in Hong Kong, and 35 on the Cayman Islands.³⁶⁹ 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 secrecy of 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.³⁷⁰ Since Hong Kong neither imposes any restraint on listed firms' operation areas and uses of funds raised, nor agrees with Taiwan's government to help enforce the Restrictions, HKSE, as a supplier for a listing product of legal flexibility in dealing with the Capital Controls and Constraints, progressively becomes a favorite fund-raising venue for Taiwanese firms in need of investing in China.

Apart from Hong Kong, in the jurisdictional competition for Taiwanese firms among global legal centers, other OFCs are crucial suppliers for regulatory products of legal flexibility in dealing with the Capital Controls. Taiwan's Capital Controls are laws that seek 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). Taiwanese firms, after turning into MNCs which create multinational production and distribution networks, may therefore be inclined to minimize the more costly operation of

³⁶⁹ Xu, *supra* note 257, at 140.

³⁷⁰ See Lin, *supra* note 225, at 85, 89.

headquarters and listing activities in Taiwan, and favor their economic transactions conducted in Hong Kong and other OFCs not least located in British Central America. These OFCs not only operate company registries and similar activities, but also “secure high value added transactional work creating and managing business entities.”³⁷¹ 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.³⁷² For example, “[b]y being prepared, Cayman profited from the flight of capital from the Bahamas after independence. Cayman developed new products, expanding beyond a company registry and banking to hedge funds and captive insurance.”³⁷³ 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 secrecy of investment in Mainland China but also the flexibility of capital movement, which increases “the cost-effectiveness of the regulatory package.”³⁷⁴ Competition on this margin would 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 offering legal flexibility for TDI in China enables avoidance

³⁷¹ Morriss, *supra* note 365, at 8-9.

³⁷² *Id.*

³⁷³ *Id.* at 52 (footnote omitted).

³⁷⁴ *Id.* at 22.

of exit taxes if operations of headquarters and listing activities can be moved to the offshore jurisdiction. In doing so, these OFCs impose a limit on 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" such as IPOs which could have stayed in Taiwan.³⁷⁵ 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 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. . . ."³⁷⁶ As Prof. Morriss adds,

[j]ust as China's market is sufficiently large that foreign investors are willing to tolerate levels of corruption and uncertainty that they would not accept in a much smaller jurisdiction, so too are investors willing to accept regulatory costs or poorly designed regulatory schemes in giant economies like the United States or European Union.³⁷⁷

³⁷⁵ *Id.* at 34.

³⁷⁶ *Id.* at 23-24 (alteration in original).

³⁷⁷ *Id.* at 61-62.

In fact, 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. 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.³⁷⁸ Prof. Morriss points out:

Democratically-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. . . . With respect to democratically-constrained regimes, the primary danger of a lack of regulatory competition is increased rent-seeking by interest groups. If restrictions on trade, capital flows, and activity by foreign entities can be used to insulate an area of economic activity from international competition, the business entities involved in that area will be able to generate rents. Those rents can then be partially captured by politicians.³⁷⁹

In the Taiwan case, international jurisdictional competition is likely to have a significant impact on Taiwan’s Capital Controls which seeks to change private behavior by altering incentives. Because of these OFCs’ focus on maximizing their revenue from

³⁷⁸ *Id.* at 71-73.

³⁷⁹ *Id.* at 26.

the sum total of transactions occurring within their jurisdictions, they are less likely 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 no bargaining chips for regulatory cooperation. Competition from these OFCs is thus likely to exert greater pressure on regulatory efforts of the Capital Controls, thus forcing Taiwan's government to gradually reduce them.

In sum, these OFCs such as Hong Kong and those located in British Central America, in non-cooperating with Taiwan's government, exercise an important discipline on Taiwan's government by allowing Taiwanese firms and capital to route around excessive law and regulations to lower transaction costs of TDI in China. Meanwhile, the above discussion to an extent demonstrates why Taiwan's Capital Controls are relaxed stage by stage over time, as more and more capital are invested in China and evasion via OFCs becomes more and more rampant in the meantime.

2.1.3 Home Regulation Invalidated by Internationally Oriented Taiwanese Firms with the Denationalization of Financial Capital

Changing into "autonomous business communities that have integrated their operations into a global division of labor,"³⁸⁰ 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."³⁸¹ As Leng further explains,

³⁸⁰ Tse-Kang Leng, *State and Business in the Era of Globalization: the Case of Cross-Strait Linkages in the Computer Industry*, 53 CHINA J. 63, 63 (2005).

³⁸¹ Leng, *supra* note 204, at 508.

National security is the government's main concern, but Taiwan's active business community has blurred the line between economic and political concerns. . . . [T]he internationalization of market and enterprise operations has made it more difficult for the state to control capital flows and investment activities. It is the international market that has created the gap between governmental policies and investment behavior.³⁸²

In concrete terms, Leng argues,

research on economic statecraft shows that such coercive tactics as sanctions do not work well after such new actors as . . . [MNCs] have appeared. A home country government cannot easily influence corporations that acquire their capital, technology, and sales through the international market. As overseas affiliations become more important to these firms, it is host country laws rather than home country policies that really influence MNCs' daily operations. The net result of market internationalization is that there is greatly intensified competition among states for world market share, and that competition forces states to bargain with MNCs to locate operations within the territory of the state and with national firms not to leave home. . . . As internationally orientated firms occupy strategic positions vis-à-vis bargaining with home and host countries, states have to adjust their roles with respect to promoting or constraining economic transactions.³⁸³

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 be disappearing. 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

³⁸² *Id.*

³⁸³ *Id.* at 494-95 (alteration in original).

longer largely retain their national identities while their headquarter activities no more mostly remained bundled in their home countries. Desai argues:

National identities can mutate with remarkable ease and [MNCs] are unbundling their headquarters functions and reallocating worldwide. The defining characteristics of what made a firm belong to a country—where it was incorporated, where it was listed, the nationality of its investor base, the location of its headquarters functions—are no longer unified nor are they bound to one country.³⁸⁴

Meanwhile, MNCs will invest in a jurisdiction with the most proper 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 efficaciously control regulatory jurisdictions' decision making.³⁸⁵ In Taiwan's case, "Taiwanese 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."³⁸⁶ The above analysis of how the Taiwanese business community has dealt with their home country's restrictive policies when they invest 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.³⁸⁷

³⁸⁴ Desai, *supra* note 301, at 1271-72 (alteration in original).

³⁸⁵ 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 and Taiwan's Accession to WTO*], 1 GUO JIA ZHENG CE LUN TAN [NAT'L POL'Y F.] (ISSUE 9) 157, 162 (2001) (Taiwan).

³⁸⁶ Leng, *supra* note 204, at 495.

³⁸⁷ See Leng, *supra* note 180, at 35.

In particular, another factor that may cause difficulties of Taiwan's government in controlling these Taiwanese MNCs' activities is that channels through which capital can be acquired turn more. As Leng notes as early as 1998,

[a]ccording to various surveys, small- and medium-sized Taiwanese businesses in mainland China acquire about 56% - 59% of their capital from Taiwan, 25% from Mainland China, and 13% from a third country. . . . Furthermore, the PRC is considering allowing Taiwanese banks to set up branch offices in the mainland, opening the stock markets to Taiwanese businesses, and ending other financial restrictions on the Taiwanese business community.³⁸⁸

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. For example, [Want Want China], the biggest Taiwanese company of its kind in mainland China, has accumulated more than US\$63 million from the Singaporean stock market [before delisting from Singapore and then relisted its shares on HKSE to this day]. Even though Hong Kong has been an integral part of China since July 1, 1997, many Taiwanese companies are optimistic and utilizing Hong Kong as a base of financial management. Other [Taiwanese MNCs] such as Formosa Plastics undertake their projects in mainland China through branch companies or subsidiaries in a third country.³⁸⁹

Put differently, they raise the capital overseas—"a process long underway through finance companies established in the Cayman Islands and the British Virgin Islands."³⁹⁰

³⁸⁸ Leng, *supra* note 204, at 502.

³⁸⁹ *Id.* at 501 (alteration in original).

³⁹⁰ Sutter, *supra* note 184, at 536.

For instance, Formosa Plastics once embarked on the Formosa power plant project on the Mainland, which, as Leng adds,

is a typical example of how [MNCs] can evade a home country's control. Of the US\$3 billion invested, the parent company located in Taiwan has contributed only US\$400 million, or approximately 14% of the total. It is Formosa's overseas subsidiaries that will play the major investor role. International banks, including Japan's Mitsubishi and Sumitomo and several German institutions, have expressed their interest in loaning more than US\$2 billion. In other words, major financial support has come from international, rather than domestic, sources.³⁹¹

In sum, after Taiwanese firms are equipped with the ability of international planning and management, Taiwan's government often fails to effectively control every MNC everywhere with the enhancement of their exit right to evade the Capital Controls. In other words, "the increasing globalization of business would be rendering local lawmaking authority obsolete."³⁹² The impacts of globalization in general and the denationalization of financial capital in particular have profoundly undermined the territorial basis of the Capital Controls.

2.1.4 Economic Sovereignty of Nation States Eroded by Economic Globalization and 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

³⁹¹ Leng, *supra* note 204, at 503 (alteration in original).

³⁹² O'HARA & RIBSTEIN, *supra* note 27, at 222.

that are weakening the role of the nation state should promote a focus of shared ‘civilian governance’ between Taiwan and mainland China.”³⁹³ As Leng adds,

[f]rom the political perspective, however, rivalry across the Taiwan Straits in the past decades forces the Taiwanese state to intervene in economic transactions. Attempts to guarantee “economic security” and a web of national security have been in great debate since Taiwan opened trade links with mainland China in 1987. However, experiences in the past decade show that economic globalization has made traditional methods of economic regulation and constraint policies invalid. . . . National security considerations have always been of serious concern for Taiwan in managing cross-Straits economic relations. As Taiwan’s economic development becomes more dependent on the mainland market, the Taiwanese state perceives rising pressures to accommodate *business interest* and political quests of autonomy. On the other hand, recent trends of economic globalization further weaken the regulatory capacities of national states and introduce external factors such as World Trade Organization (WTO) to institutionalize normal economic relations with Mainland China.³⁹⁴

To tentatively summarize, the removal of trade barriers for Taiwan’s and China’s joining the WTO (“the institutionalized force of globalization”)³⁹⁵ combined with the capital mobility enhanced by the denationalization of financial capital could exert transformative pressures on Taiwan’s government to seek progressive deregulation of the Capital Controls to meet business demands created under the power of economic globalization.

Further, “[t]raditional wisdom regarding economic security focuses on how economic statecraft influences economic transactions. Spurts of economic globalization since the last decade of the twentieth century have forced nation states to readjust their

³⁹³ Leng, *supra* note 181, at 261.

³⁹⁴ *Id.* at 261-62 (footnote omitted) (emphasis added).

³⁹⁵ *Id.* at 262.

roles in economic life.”³⁹⁶ Under globalization, as Ulrich Beck argues, “[c]orporations with the advantages of mobility and a global network are able to weaken individual states by playing them against one another.”³⁹⁷ Ronen Palan argues that the state, faced with this challenge, should not retreat but instead restructure capacities to cope, especially to meet rising demand from the business community, that countries in principle respond similarly to the forces of globalization, and that they are therefore compelled to compete by offering attractive legislative packages to corporations.³⁹⁸ For instance, Leng’s case study of talent flows between Taiwan and China spurred by economic globalization also delves into what motivates Taiwan’s government to intervene in cross-Strait talent interaction while illuminating what limits its regulatory efforts:

Due to many non-economic concerns such as national security, Taiwan’s policies to attract advanced talent from China are more cautious. The Taiwanese state tries to limit capital and personnel outflows to China but falls short of operational instruments in the era of economic globalization. Facing the multiple challenges of promoting international competitiveness, reconstructing the global networking of production, and attracting top talent around the world, the state is compelled to readjust its role and adopt the strategy of selective intervention and selective withdrawal in the era of globalization.³⁹⁹

Let’s 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

³⁹⁶ *Id.* at 278.

³⁹⁷ Ulrich Beck, *Redefining Power in the Global Age: Eight Theses*, 48 *DISSENT* 83, 86 (2001).

³⁹⁸ Ronen Palan, *Recasting Political Authority: Globalization and the State*, in *GLOBALIZATION AND ITS CRITICS* 139, 158 (Randall D. Germain ed., 2000).

³⁹⁹ Leng, *supra* note 188, at 231.

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 evolution for firms to become MNCs] have had a direct effect on regulators, because they have made it easier for firms [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.⁴⁰⁰

In short, under globalization, the increase of 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.

In the Taiwan case, as explicated in more detail below, the changes in the Capital Controls reveal the dynamics of international jurisdictional competition among global legal centers, or the demand and supply forces underlying the international law market at work. The Capital Controls promulgated by the executive branch of the government,

⁴⁰⁰ Jonathan R. Macey, *Regulatory Globalization as a Response to Regulatory Competition*, 52 EMORY L. J. 1353, 1355 (2003) (alteration in original).

specifically MOEA, are evidently excessive and against business demands, so that China-based Taiwanese firms turn to other regulatory jurisdictions to satisfy their demands for legal flexibility. The international jurisdictional competition among global legal centers 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, e.g. the Cayman Islands (for corporate charters and relevant financial services) or Hong Kong (for listings), of alternative regulatory products without being subject to the Capital Controls, these Taiwanese MNCs could attempt regulatory arbitrage. At this time although Taiwan's government agencies, knowing futility of acting unilaterally, intend to look for regulatory cooperation, or "regulatory globalization,"⁴⁰¹ to enforce the Capital Controls, those competing jurisdictions have no reasons to help Taiwan's agencies to enforce the Capital Controls, given their own markets for those prosperous China-based Taiwanese firms and that Taiwan has no bargaining chips for 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 "exits" from local markets, Taiwan, under the interest group

⁴⁰¹ As Macey argues,

regulatory globalization is a competitive response employed by administrative agencies when they perceive a threat to their power. Where exogenous technological forces threaten to make an agency acting alone obsolete or irrelevant, a natural response is regulatory globalization. In short, when regulated firms attempt a "divide and conquer" strategy of isolating regulators and engaging in regulatory arbitrage, regulators have little choice but to band together and offer a coordinated response.

Id. at 1377. See also Leng, *supra* note 180, at 35, 38; John Whalley, *Globalisation and Values*, 31 WORLD ECON. 1503, 1513 (2008), available at <http://ssrn.com/abstract=1288887> (arguing that "[t]o political scientists, globalisation suggests global political processes in which there are challenges to national authority structures as mobility across nations accelerates and transfer of nation state functions to supra-national authorities occurs. It leads to evaluation of transnational political processes, assessments of constraints on the autonomy of national authorities . . .").

competition to “voice” the petition for liberalization, experiences a radical change of political power in 2008 particularly as President Ma of KMT, advocating anti-regulatory and pro-China policies, wins the presidential election. Large-scale relaxation of the Capital Controls is subsequently launched in a timely manner.

2.2 Business Demands Nudge the Capital Controls towards the Relaxation

2.2.1 The Relaxation from NHBP in 1997 to PLEM in 2001

How do 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.⁴⁰² 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 policies and will continue to be so in the foreseeable future.”⁴⁰³ This fact points out that official policies are lagging behind those of business entrepreneurs. In addition, Leng finds:

⁴⁰² See Chang & Goldstein, *supra* note 190, at 34-35.

⁴⁰³ Leng, *supra* note 204, at 502 (alteration in original).

Medium-sized enterprises have extended their reach in the anticipation that prohibitions would be lifted. For example, although the government still bans investment in the cement industry in mainland China, major Taiwanese cement companies have begun to establish factories and other related industries, e.g., aggregate materials, in preparation for a relaxation of the ban. Cement companies have also used the bargaining power of trade unions to press the Taiwanese government to lift restrictions.⁴⁰⁴

Moreover, given that the business community advocated 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.⁴⁰⁵ 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 were delivered into the regulatory evolution from the NHBP policy to the PLEM policy.

Second, the WTO factor also matters in bringing the transition from NHBP to PLEM. It is worth quoting Leng's account at some length:

The real challenge and opportunity to Taiwanese firms and Taiwan's economic security comes from the WTO. Many issues of cross-Strait economic interaction will be governed under the WTO framework [after] Taiwan and China succeed in entering this multilateral trade regime. From a more positive perspective, WTO regulations lower tariffs and increase economic transparency across the Taiwan Straits. WTO also leads to the perfection of a legal environment which facilitates Taiwanese commodity exports and investment to mainland China. . . . Big [MNCs

⁴⁰⁴ Leng, *supra* note 204, at 502-03.

⁴⁰⁵ See also Weng, *supra* note 339, at 46.

from other industrial countries] may also replace the [then] existing Taiwanese enterprises as better technology and service providers in mainland China. . . . All in all, the Taiwanese government can no longer maintain the [strict NHBP] unilateral policies that restrict cross-Strait economic transition. The real challenges of economic dependence are not from potential economic statecraft from mainland China, but rather due to the structural [WTO] factor of institutionalized economic globalization. Facing direct challenges from MNCs [from other countries], the Taiwanese business community may also increasingly [voice] to push the [Chen] administration to adjust the [NHBP] restraint policies toward mainland China.⁴⁰⁶

From the viewpoint of the law market forces, the WTO factor 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 antiquated NHBP policy.

Third, under the trends of economic globalization, international division of labor drives Taiwanese firms to substantially invest in Mainland China to lower production costs and capture Chinese domestic markets. The business community thus continues voicing their petition for liberalization of the NHBP policy,⁴⁰⁷ which culminates in EDAC held in August 2001, determining the regulatory transition from the NHBP policy to the PLEM policy.⁴⁰⁸ In this arena for interest group competition, KMT, turning to embrace an anti-regulatory and pro-China position after the defeat in the presidential election in 2000, actively voices its support for relaxation of the Capital Controls that

⁴⁰⁶ Leng, *supra* note 181, at 267-68 (alteration in original).

⁴⁰⁷ See Qiu, *supra* note 192.

⁴⁰⁸ See Jiang, *supra* note 331, at 51-52.

Taiwan's government should help firms operate globally with the strategy of international planning and management in order to follow the trends of economic globalization.⁴⁰⁹ Moreover, during the period of EDAC, the following six major local chambers of commerce, as anti-regulatory interest groups, push for this transition as well:⁴¹⁰ CNFI, ROCCOC, the Chinese National Association of Industry and Commerce, Taiwan ("CNAIC")⁴¹¹, National Association of Small and Medium Enterprises Republic Of China ("NASME R.O.C.")⁴¹², Taiwan Federation of Industry ("TFI")⁴¹³, and Taiwan Electrical and Electronic Manufacturers' Association ("TEEMA").⁴¹⁴ Therefore, EDAC, on the one hand, acts as a sort of feedback mechanisms 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 lacks 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.⁴¹⁵

⁴⁰⁹ *Ru He Tu Po Dang Qian Jing Ji Kun Jing Xi Lie Zuo Tan Hui Ju Ti Jian Yi [Concrete Recommendations from Serial Symposia on How to Get Over the Current Economic Distress]*, 1 GUO JIA ZHENG CE LUN TAN [NAT'L POL'Y F.] (ISSUE 7) 1 (2001) (Taiwan).

⁴¹⁰ Jin-Yu Tan, *Cong Liu Da Gong Shang Tuan Ti Jian Yan Tan Jing Fa Hui [On EDAC, Considering Advice from Six Major Industrial and Commercial Organizations]*, 1 GUO JIA ZHENG CE LUN TAN [NAT'L POL'Y F.] (ISSUE 8) 118, 118 (2001) (Taiwan).

⁴¹¹ CNAIC "is a private, independent and non-profit organization composed of commercial and industrial groups, financial institutions, business associations, industrialists, and businessmen in the Republic of China (R.O.C.) in Taiwan," and "was founded on February 17, 1952 mainly representing the interests of business community in Taiwan, promoting industrial developments in line with government policies, as well as enhancing international trade and industrial cooperation with other countries." CNAIC, <http://www.cnaic.org/web/index.asp?lang=2> (last visited Apr. 18, 2009).

⁴¹² NASME R.O.C. was founded in 1972 with a primary objective to help Taiwanese small- and medium-sized enterprises improve on their operation. NASME R.O.C., <http://www.nasme.org.tw/front/bin/home.phtml> (last visited Apr. 18, 2009).

⁴¹³ TFI was founded on May 23, 2001 mainly to reflect petitions from the basic level of industries. TFI, <http://www.tfoi.org.tw/html/index.asp> (last visited Apr. 18, 2009).

⁴¹⁴ TEEMA, <http://www.teema.org.tw/index.asp> (last visited Apr. 18, 2009) ("TEEMA was established in 1948 to serve the interests of Taiwanese electrical and electronics industries and to provide a point of liaison between the industry, its customers and the government").

⁴¹⁵ As Leng notes with respect to the exercise of the voice rights by the Taiwanese business community in this regulatory transition,

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."⁴¹⁶ 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."⁴¹⁷ 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.

2.2.2 The Relaxation from PMEL in 2006 to Large-Scale Liberalization in 2008

big business groups in Taiwan are also in the transitional period of enhancing their collective bargaining capacities on both sides of the Taiwan Straits. In Taiwan, the defeat of KMT in the presidential election [in 2000] also signifies KMT's loss of control over the major trade and industrial unions. In order to create new connections with the business community, the new [Shui-Bian Chen] government is expected to provide more preferential treatment on the issue of mainland trade [and investment]. Furthermore, endorsement from many business groups for Chen's bid for presidency was based on the expectation that Chen will reverse the mainland investment restraint policy adopted during the Lee Teng-hui presidency. Most of these supports from the business community to Chen have potential business interests if Taiwan releases investment restrictions [of the NHBP policy]. For example, within Chen's 'National Affairs Advisory Committee', the Evergreen Group will take the initiative if Taiwan realizes direct sea and air connections with mainland China, while the Continental Engineer Group will benefit from new investment projects in mainland's huge infrastructure market.

Leng, *supra* note 181, at 267 (alteration in original). See also Ching-Wen Tzou, *Taiwan Ge Zheng Dang Da Lu Zheng Ce Yan Bian Yu Ying Xiang [The Evolution and Effect of the Mainland China Policies of Both Major Political Parties in Taiwan]*, in LIANG AN KAI FANG ER SHI NIAN HUI GU YU ZHAN WANG [THE RETROSPECT AND PROSPECT OF THE 20 YEARS FROM THE OPENING OF CROSS-STRAIT EXCHANGE] 7, 24-25 (Chung-Cheng Chen et al. eds., 2007) (Taiwan).

⁴¹⁶ *Id.* at 264 (alteration in original).

⁴¹⁷ *Id.* at 265 (alteration in original).

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."⁴¹⁸ 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, push 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 is unilaterally decided by the Chen administration, not as the liberalization towards PLEM in 2001 is determined in EDAC, an operant arena for collective policy making, or formal interest group competition. Therefore, the stricter PMEL policy not simply ignores business demands for aggressive investment in Mainland China⁴¹⁹ and for concomitant legal flexibility, but also undermines the Chen administration's reputation established during EDAC in 2001 to cater for market demand. As discussed above, in response to this transition towards more regulation in 2006, Taiwanese firms, on the one hand, continued voicing their petition to liberalize the Capital Controls in a variety of ways.⁴²⁰ On the other hand, they exited from Taiwan's stock markets to list shares overseas or further substantially transfer their funds abroad

⁴¹⁸ Leng, *supra* note 380, at 75.

⁴¹⁹ See also Weng, *supra* note 339, at 95.

⁴²⁰ 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).

for investments in China through underground channels, so as to avoid the more severe regulation.

As expounded above, though 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 reconfirmed by the prediction made by the two investment banks prior to the relaxation in 2008 when interviewed by I-Ru Liu Team:

The Capital Controls have compelled Taiwanese companies to go public in Hong Kong or even Singapore. This also discouraged many China-based Taiwanese businesses from listing back in Taiwanese stock markets. If we don't take any aggressive action to change the policy, as soon as some leading large conglomerates in Taiwan decide to wholly exit from Taiwan's markets, their physical exit will substantially negatively impact Taiwan. And then their exit will further stimulate foreign capital to depart from Taiwan. What happened at that time probably collapses defense of the Capital Controls.⁴²¹

The conclusion made by the above interviewees can be lively illustrated by the sensational 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 which earlier broke out in the legislature in November 2006, but also strengthened the business community's voice for legal flexibility, which might eventually galvanize liberalization of the Capital Controls and Constraints in 2008. To begin with, ASE, founded in 1984 in Taiwan and later listed on TWSE, is one of the world's leading

⁴²¹ *Internationalization, supra* note 237, at 69.

providers of semiconductor manufacturing services and the globally largest supplier of a comprehensive range 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 first, 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 cannot agree over the purchase price.⁴²² As commentators emphasized, however, 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 in form acquired ASE, this company’s original owners and management could in substance indirectly keep holding 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 whether or how the new ASE would invest in Mainland China.⁴²³ The attempt that ASE would become a foreign company, be delisted from TWSE, and re-list shares overseas means that by changing its nationality, or looking for somewhere to reincorporate, ASE would maximize its exit right to raise funds elsewhere without being subject to the Capital Controls and Constraints.⁴²⁴

⁴²² Wen-Chieh Wang, Kai-Lin Faung & Jerry G. Fong, *Taiwan Guan Li Ceng Shou Gou Zhi Fa Lü Wen Ti* [Legal Issues of Management Buyouts in Taiwan: The Cases of ASE Group and Fu Sheng Group], 15 YUE DAN CAI JING FA ZA ZHI [FIN. & ECON. L. REV.] 1, 2, 5 (2008) (Taiwan).

⁴²³ Jung-Pao Kang, *Tai zi Qi Ye De Liang An Bei Qing Fen Xi—You Ri Yue Guang Bing Gou An Tan Qi* [Strategies to Avoid Restrictions on Investment in China: Examples Starting from ASE Group], 4 ZHAN WANG YU TAN SUO [PROSPECT & EXPLORATION] (ISSUE 12) 1, 2-3 (2006) (Taiwan).

⁴²⁴ See Fong, *supra* note 232, at 100; Zhen-Wen Hu, *Cong Ri Yue Guang An Kan Si Mu Ji Jin* [On Private Equity Funds in Light of the Case of the ASE Group], QIAN ZA ZHI [MONEY] (Taiwan), Dec. 2006, at 77, 77;

The Taiwanese business community was then in an uproar over ASE's voting with feet; it was said that many China-based Taiwanese companies chained with the regulation took into account following its lead. ECCT, AmCHam, and many local chambers of commerce started eagerly requesting the government to loosen the Restrictions, and even through the legislature made such a request.⁴²⁵ 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 begin vehement pressures for the relaxation of the Capital Controls via the legislature among

Ri Yue Guang Bei Bing Gou An Xiao Ying Dui Taiwan Ke Ji Chan Ye You Ti Sheng Jia Zhi Xiao Guo [The Impact of the ASE Case Advances the Value of Taiwanese Technology Industries], DIAN GONG XI XUN YUE KAN [TEEMADATA] (Taiwan), Mar. 2007, at 18, available at <http://www.teema.org.tw/publish/moreinfo.asp?autono=3229>. This case might also be examined from a general perspective of economic globalization. For instance, Dignam and Galanis argue:

All this indicates that the intensification of economic globalization since the mid-1980s is gradually giving rise to a particularly active global market for corporate control. Significantly, this global market for corporate control demonstrates how capital mobility at the macroeconomic level can interact with organizational restructuring at the micro level. Such transactions, especially when large corporations are involved, require enormous amounts of capital that often exceed not only the funds available within the company, but also the capacity of national financial markets. For large companies, however, this is not a significant constraint because in a world without capital controls they have the capacity to tap global capital markets in order to obtain the funds they may need. Although the globalization of equity markets is still at an early stage, large corporations can effectively finance their activities through multiple-equity offerings, tapping most major stock markets simultaneously.

Dignam & Galanis, *supra* note 171, at 238 (footnote omitted).

⁴²⁵ *Tai Min Sheng Bao*: "Ri Yue Guang" Shi Bian Wu Neng Wu Du Suo Hai [Minsheng Daily (Taiwan): The ASE Case Is Caused by the Chen Administration's Erroneous Policy], REN MIN WANG [PEOPLE'S DAILY ONLINE] (P.R.C.), Nov. 30, 2006, <http://tw.people.com.cn/BIG5/14811/14869/5106417.html> (last visited Nov. 2, 2007); *Feng Xing Suo Tai Zheng Ce De Tai Dang Ju Xing Xing Ba!* [United Daily News: Taiwan's Government Needs to Wake Up from the Insistence on Mainland-Investment Restrictions], REN MIN WANG [PEOPLE'S DAILY ONLINE] (P.R.C.), Dec. 3, 2006, <http://tw.people.com.cn/BIG5/14811/14872/5118020.html> (last visited Nov. 2, 2007); *Tai Qi Ri Yue Guang Bing Gou An Yin Fa Dao Nei Jian Tao Liang An Zheng Ce Tao Lun* [The ASE Case Triggers an Intense Debate within Taiwan over Mainland-Investment Restrictions], REN MIN WANG [PEOPLE'S DAILY ONLINE] (P.R.C.), <http://tw.people.com.cn/BIG5/14812/14875/5096784.html> (last visited May 27, 2009).

other things.⁴²⁶ The ASE case obviously sparked the formal interest group competition in the legislature over the relaxation of the Capital Controls,⁴²⁷ 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,⁴²⁸ and made two proposals to modify the Act with different scope of relaxing the Capital Controls, in order to solve the predicament into which Taiwanese companies with much investment in China get. Even though more than 100 legislators⁴²⁹ signed their support for these two proposals, the legislature was not then able to pass the proposals of relaxation due to rejection by legislators of the former ruling party, DPP, and its allies. They were the majority at that time and took the anti-China and pro-regulatory stance.⁴³⁰

During the regulatory transition of the Capital Controls for this time, the debate over whether to further liberalize the Capital Controls after the attempt of ASE's MBO broke out is but one case, albeit a highly critical one presaging large-scale ease 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

⁴²⁶ 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 the Executive Yuan 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).

⁴²⁷ Weng, *supra* note 339, at 115.

⁴²⁸ O'Hara & Ribstein, *supra* note 270, at 2152 ("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").

⁴²⁹ There were, in total, 225 seats in Taiwan's legislature at that time.

⁴³⁰ *Internationalization*, *supra* note 237, at 87.

provoked by the ASE case failed then, it was a dry run of the later successful exertion of voice rights in the first half of 2008. Just as the two investment banks interviewed by I-Ru Liu Team predicted above, the Restrictions forced Taiwanese companies with substantial investment in China to list their shares overseas, HKSE among others, to raise capital that can 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 among global legal centers. 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 other OFCs in British Central America. The pressure for relaxation has greatly been building up on the Taiwanese government. For instance, in a newsletter 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 confess the investment caps according to the unitary proportional design comforted neither to economic principles nor to the initial intent of the security element of the Capital Controls (Effective Management).⁴³¹

As a result, both phenomena that the former DPP government maintained and even re-tightened the Restrictions in 2006 and that Taiwan-invested firms thus flocked to list shares overseas to avoid the Capital Controls and Constraints might arguably drive 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

⁴³¹ *Liang An Zheng Ce Xu Yao Shan Yi Gou Tong Pan Wai Jie Wu Yi Wei Pi Ping* [Cross-Strait Policy Requires Amicable Discussion; Mainland Affairs Council Wishes Less Malicious Criticism], FA YUAN FA LÜ XIN WEN [LAWBANK'S L. NEWS] (Taiwan), Nov. 22, 2007 <http://www.lawbank.com.tw/fnews/pnews.php?nid=53743.00> (last visited Nov. 22, 2007).

presidential election in March 2008. This domination in the political marketplace can be substantiated by the almost identical promises from both candidates in this presidential election to embrace the future liberalization of the Capital Controls. In other words, given the torrential exodus of Taiwanese firms, both presidential candidates of different parties were in favor of prospective relaxation of the Capital Controls; the trifling difference merely lay in the scope of liberalization. Where the regulation might be excessive, 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 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.

2.2.3 Legal Flexibility Enabled by International Jurisdictional Competition under Globalization

As Leng notes, "Taiwan's official economic policies concerning investment in China today have changed considerably. [Their past transitional trajectories] reflect an on-going tug-of-war in Taiwan between national security issues, the various political parties' stances on policy, and market forces."⁴³² As Figure 2 shows, why did both TDI in China and Investment Allowance move in a rising way? In face of the surge of TDI in China, why is the regulatory transition of the Capital Controls from 1997 to 2008 nudged in the direction of liberalization? We might give this paradox a causal interpretation:

⁴³² Leng, *supra* note 380, at 75 (alteration in original).

under economic globalization business demands of Taiwan-invested firms, for which TDI in China acts as a proxy, galvanize the relaxation of the Capital Controls, for which the increase of Investment Allowance is used as a proxy. As Ho and Leng argue, “[d]espite the institutional distortion and political intervention, economic interaction between Taiwan and China continued to boom in the past decade. Cross-Straits economic relations are characterized by ‘civilian governance’. The private sector takes the lead.”⁴³³ This is because trends of economic globalization weakened the role of the nation state, thereby promoting cross-Strait “civilian governance.” Specifically, Leng elaborates:

Taiwan’s state power is constrained by globalization and the localization strategies of individual Taiwanese firms. These firms have developed various networks with Chinese local governments, regardless of the policies of Taiwan’s central government to discourage this. Taiwan’s decision to lift the ban on “China initiative” had been pushed through by corporations under pressure [generated by economic globalization] to reduce costs, even though the Taiwanese state had been hesitating to promote the creation of a division of labor across the Taiwan Strait due to political concerns.⁴³⁴

Just as Sutter puts it in another way 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

⁴³³ Ho & Leng, *supra* note 198, at 738 (footnote omitted).

⁴³⁴ Leng, *supra* note 380, at 78 (alteration in original). In addition, when it comes to the historic changes in voice rights of the Taiwanese business community, as Leng discusses,

[d]uring Taiwan’s authoritarian past under Chiang Kai-shek, business interests were channelled by the patron-client framework of the one-party political system. By developing an accommodation with local KMT political factions and state-owned enterprises, the Taiwanese business community learned to co-exist with the authoritarian state. After Taiwan’s democratization, the larger enterprises formed strategic alliances with both the ruling and opposition parties to enhance their political influence, mostly through campaign donations and by helping to finance policy think tanks for the politicians. For small- and medium-sized firms, the most common way to enhance their access to power was to establish various business associations and to engage in informal group consultations and lobbying.

Id. at 75.

testing and skirting the existing restrictions.”⁴³⁵ This argument foretells how the feedback mechanisms of voice and exit could once more push the transition to a more flexible policy of the Capital Controls, which just took place in 2008.

Furthermore, regarding how the feedback mechanisms of voice and exit might bring about a change in the Capital Controls, Sutter puts it in a more detailed way:

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* [(what Hirschman has referred to as “voice”)] and, perhaps more important, *indirectly by bypassing regulations to satisfy commercial demand in the PRC* [(what Hirschman called “exit”).⁴³⁶

This argument lends support for the causal 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 ineffective.

⁴³⁵ Sutter, *supra* note 332, at 28-29.

⁴³⁶ Sutter, *supra* note 331, at 523 (alteration in original) (emphasis added).

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 among global legal centers. 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 in order to be devoted to global division of labor. Nevertheless, Taiwan's Capital Controls, the excessive regulation favored by local pro-regulatory interest groups, ignores business demands not simply for surely 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 does struggle 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 knowhow across the Strait, and therefore can merely slow but not effectively contain these firms' physical exit. In the international economic process, the demand force of the law market, through the exercise of exit rights of Taiwanese firms avoiding the 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 effectively giving Taiwanese firms an exit route. Then the international supply force of the law market activates interest group competition on the domestic supply side within the island. In another word, such economic exits send 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) might exercise their voice rights strengthened by physical exit and threats or exit to promote legal flexibility together with exit-affected interest groups. These economic signals in turn pressure politicians or 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 concisely exhibited as in Figure 3.

3. Competing Explanations for the Taiwan Case

To be sure, some might suspect that there could be alternative theories to account for the above Taiwan case. Any effort to employ the jurisdictional competition theory to elaborate the Taiwan case thus needs to address the following competing explanations.

3.1 What Are Politicians' Incentives?

Some theorists might argue that it is possible that the Taiwanese government, by pushing through the Capital Controls which is very strict at face value, actually allowed

most firms most of the time to avoid this regulation (e.g., by creating loopholes in it). 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.⁴³⁷

Accordingly, it was possible that Taiwan’s government might have complex incentives to regulate outward investment in Mainland China, and that Taiwanese politicians in power might try to maximize their positions at once by manipulating the perceptions of the enforcement of the Capital Controls while reaping a private profit from this action that mitigate the discrepancy between the actual and the perceived risk of outward investment in China. In other words, even though the Capital Controls are imposed, Taiwan’s government might not do their best to implement this regulation entirely.

As a matter of fact, the following evidence could demonstrate the efforts of Taiwan’s government to enforce the laws thoroughly, thus helping rule out the above explanation. Firstly, according to Taiwan HsinChu Difang Fayuan [Taiwan HsinChu Dist. Ct.], 95 Zhu Su Zi No. 1 (2006) (Taiwan), as mentioned in Part A.1.2.2.2 of this chapter, the three defendants who were the executive management of UMC were indicted for relevant acts involving investment in Mainland China without prior approval of MOEA,

⁴³⁷ Amitai Aviram, *Bias Arbitrage*, 64 WASH. & LEE L. REV. 789, 789 (2007).

even though they were afterwards held not guilty by the district court in 2007, which was later confirmed by the court of appeals in the end of 2008. These UMC executives actually maintained good political liaison with the former ruling party, DPP. For instance, when UMC was suddenly searched by prosecutors and agents from Taiwan's Investigation Bureau, Ministry of Justice 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 eliminating UMC.⁴³⁸ More importantly, as Mr. Ker noted, as soon as President Shui-Bian Chen won the presidential election in 2000, the first company President Chen visited was UMC, and that Robert H. C. Tsao (UMC's former chairman of the board) had been President Chen's Presidential National Policy Adviser.⁴³⁹ This prosecution followed by MOEA's NT\$5 million administrative fine was a leading case from the time Taiwan's government announced its intention to re-tighten the Capital Controls in 2006, and illustrated the government's continuous efforts to thoroughly enforce the Capital Controls by all available administrative or judicial means.⁴⁴⁰

Secondly, 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 Taiwan government

⁴³⁸ Ren-Wen Zheng, *Sou Lian Dian Jian Zhi Chao Jia Mie Zu Ker Chien-ming Po Kou Ma* [Chien-Min Ker Condemned the Search for UMC as Exterminating It], ZHONG SHI WAN BAO [CHINA TIMES EXPRESS] (Taiwan), Feb. 7, 2005, at 1.

⁴³⁹ Hui-Zhen Cai, Jia-Hong Chen, Feng-Qin Lui & Shu-Ling Lin, *Lian Dian Zao Sou Suo Cao Xing-Cheng Bao Liao Zhong Xin Wo Di Gao Mi; Fu Yuan Cheng Shi Xian Bu Zhi Jian Diao Dong Zuo Zheng Tan Da Xian Yin Mou Lun Gao Ceng Ji Shang Jiang Di Fu 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.

⁴⁴⁰ See Li, *supra* note 336, at 129; UMC, *supra* note 278.

broadened 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. For example, according to Zuigao Xingzheng Fayuan [Sup. Admin. Ct.], 92 Pan Zi No. 1463 (2005) (Taiwan), the defendant MOEA argued that the plaintiff Long Chen Paper Co., Ltd. (“LCPC”) through YUMA, a corporation registered in Singapore, incorporated MAIDI, a company registered in Guangzhou, PRC, and that in LCPC’s annual report of 1999 delivered to shareholders LCPC regarded YUMA’s investment in MAIDI as its own. MOEA thus deemed that without its prior approval LCPC’s above conduct was in violation of Paragraph 1 of Article 4 of the Regulations, which stipulates: “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” Consequently, MOEA punished LCPC with an administrative fine of NT\$1 million. LCPC appealed ultimately to the Supreme Administrative Court. This court held in favor of MOEA that although the investment in MAIDI was made in YUMA’s name, *it was LCPC that actually invested in establishing MAIDI* and received the profit and loss generated from the investment of MAIDI, and that LCPC’s delegating investment in MAIDI to YUMA should therefore be deemed “investment in the Mainland Area,” thus violating Paragraph 1 of Article 4 of the Regulations. In effect, were it not for LCPC’s voluntarily disclosing its investment in Mainland China, which is merely required for a publicly-held company under Taiwan’s securities and company laws, it would be difficult for MOEA to meet its burden of proving the violation.

In addition, according to Zuigao Xingzheng Fayuan [Sup. Admin. Ct.], 95 Pan Zi No. 1065 (2006) (Taiwan), the defendant MOEA argued that the plaintiff Chen-yu Venture Capital Co., Ltd (“Chen-yu”) invested \$2 million in Semiconductor Manufacturing International Corporation incorporated in Cayman Islands (“SMIC, Cayman Islands”), which held 100% of share capital of another company, Semiconductor Manufacturing International Corporation incorporated in Shanghai, PRC (“SMIC, Shanghai”), and that the plaintiff’s investment should be regarded in a general sense as an “investment in the Mainland Area” forbidden by Paragraph 1 of Article 4 of the Regulations, which stipulates: “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 . . . 3. Acquiring the equity of, and operating, an existing local company or business entity, but excluding the purchase of stock of a listed company” In consequence MOEA punished the plaintiff with an administrative fine of NT\$1 million. Chen-yu ultimately appealed to the Supreme Administrative Court. This court held that one should define the term “investment in the Mainland Area” *from a perspective of substance*, and that SMIC, Cayman Islands should therefore be deemed *the alter ego of Chenyu*; that is, Chenyu, rather than SMIC, Cayman Islands, was *the very legal entity investing in SMIC, Shanghai*.

Based on the last two judgments made by the Supreme Administrative Court, this court held that the term “investment in the Mainland Area” should be interpreted from a perspective of substance, not of form. In other words, even though Taiwanese parent companies, as explained above, establish corporations in a third area such as an OFC or

delegate investment in Mainland China to a company in that third area, those companies established or delegated 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 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 the Capital Controls further demonstrated the Taiwanese government's efforts to enforce the laws thoroughly.⁴⁴¹

3.2 Does a Macroeconomic Policy Shift from Bretton Woods-Style Fixed Exchange Rates to Floating Exchange Rates More Matter?

Some might think that the movement to relax the Capital Controls has little to do with Taiwan-China trade and investment specifically, and more to do with a macroeconomic policy shift from Bretton Woods-style fixed exchange rates (which are difficult to sustain in an open economy, and therefore require some kind of capital controls) to floating exchange rates coupled with the removal of exchange controls and financial regulations that limit capital flows. In fact, both factors equally have much to do with the relaxation of the Capital Controls. The difference rests on the fact that Taiwanese firms' business demands for cross-Strait trade and investment are the proximate cause to drive the government to lighten the Capital Controls stage by stage

⁴⁴¹ As discussed in Part A.2.3 of this chapter, 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.

from 2001, whereas the above macroeconomic policy shift is the remote cause to strike a transformative blow at the heart of the Capital Controls. As discussed above in Chapter 3.B.1.2.1, this is because the macroeconomic shift lifted the limits on Taiwanese capital mobility in the first place; the heightened capital mobility in turn led Taiwanese firms to invest increasingly in foreign areas (including Mainland China) as exit costs decreased substantially.

In other words, the shift from fixed to floating exchange rates considerably promotes the mobility of Taiwanese capital and firms in the first instance. This mobility then leads to the increasing business demands for trade with and investment in Mainland China, which serve as an immediate cause for the relaxation at issue. The Capital Controls were initially imposed mainly in response to Chinese military and political intimidation between 1995 and 1996. In a word, as displayed in Figure 3, spurts of economic globalization (including not simply the inevitability of Taiwan's removal of cross-Strait trade and investment barriers with a view to acceding to WTO in 2002, but also the capital mobility advanced by the macroeconomic policy shift mentioned above as a remote cause) brought about international jurisdictional competition, thus applying even greater transformative pressures on Taiwan's government to seek more legal flexibility of the Capital Controls. Hence, the stage-by-stage relaxation in question took place from 2001.

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

Some might argue that it might be mere exercise of Chinese political and military power that caused the relaxation of Capital Controls. They might add that most countries that are currently civil law or common law did not adjust their legal systems due to jurisdictional competition but merely because the colonial power imposed such change. So why is the Taiwan case closer to a jurisdictional competition explanation and less similar to a mere “colonization”?

To refute this alternative theory, we may need to review the two 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 1999.⁴⁴²

In response to especially the 1995-1996 tensions, President Lee in the “Nationwide Business Owner Assembly” held in September 1996 announced the NHBP policy, which

⁴⁴² Chen-Yuan Tung, *Cross-Strait Economic Relations: China's Leverage and Taiwan's Vulnerability*, 39 ISSUES & STUD. (NO. 3) 137, 140-41 (2003) (Taiwan) (alteration in original).

unveiled the prospective imposition of the Capital Controls in a year. President Lee is quoted as then 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 major principle of “*jie ji yong ren*” [no haste, be patient] to tackle current cross-Strait relations.⁴⁴³

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 more the sanction hurts Taiwan’s government directly, the greater the chance to influence its policy, that core support groups of Taiwanese regime negatively affected by sanctions would put pressure on Taiwan’s government, and that Taiwan’s government with domestic political and economic instability would tend to concede to China’s demands.⁴⁴⁴

Nonetheless, according to Chen-Yuan Tung’s study on how the Taiwanese public, the political elite, interest groups and Taiwan’s decision-makers reacted to Chinese military and political intimidation during the 1995-1996 and 1999-2000 Taiwan Strait tensions, China’s escalating tensions in the Taiwan Strait between 1995 and 2000 did not effectively push the above parties to influence Taiwan government’s policy or to press Taiwan’s government to concede to Chinese political goals.⁴⁴⁵ In particular, there is very

⁴⁴³ Chen-Yuan Tung, *China’s Economic Leverage and Taiwan’s Security Concerns with Respect to Cross-Strait Economic Relations 2* (May. 2002) (unpublished Ph.D. dissertation, John Hopkins University) (on file with author).

⁴⁴⁴ *Id.* at 191-92.

⁴⁴⁵ TUNG, *supra* note 359, at 387-420.

little evidence that China's political strategy of "*yi shang wei zheng*" (exploiting business to press politics) was working against Taiwan in these two incidents. In general, most China-based Taiwan-invested firms asked for caution and no further provocation from Taiwan's government. Furthermore, most of these Taiwan-invested firms supported Taiwan's position. The majority of these firms strongly opposed Chinese military threats.⁴⁴⁶ 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."⁴⁴⁷ Since the relaxation of the Capital Controls is less likely attributable to mere exercise of Chinese political and military power, jurisdictional competition might be a more adequate model to think about the Taiwan case than other competing theories.

3.4 Are There Other Pro-Regulatory Forces?

Some might suspect that maybe there are a few untold pro-regulatory forces that benefit from the Capital Controls, especially some groups of Taiwanese firms which benefit from hindering others in making PRC investments by raising costs by requiring doing it via, say, BVI or the Cayman Islands.

In fact, the main reasons behind Taiwan's tough economic regulations are concerns over national security as emphasized above. This nationality security concern was made salient not least between 1995 and 1996 when China employed military and political

⁴⁴⁶ *Id.* at 418-19.

⁴⁴⁷ Tung, *supra* note 442, at 141 (alteration in original).

intimidation to influence the Taiwanese government's policy for seeking international recognition. Exactly owing to this intimidation, President Teng-Hui Lee in December 1996 convened the "National Development Conference" to form the political consensus on the Capital Controls among the ruling and opposition parties as well as almost all relevant interest groups;⁴⁴⁸ then the Lee administration formally imposed the NHBP policy and implemented the Capital Controls from July 1997.⁴⁴⁹ At that time, China's activity was so hostile to Taiwan that the pro-regulatory interest groups successfully dominated the political arena and urged the government to impose the Capital Controls.⁴⁵⁰ When it comes to some pro-regulatory considerations other than pure national security concerns, some political critiques, at most, argued: as the Capital Controls were initially imposed in 1997 pro-regulatory groups might involve politicians who cared more about Taiwan's sovereignty as well as national security and identity than economic development;⁴⁵¹ as the Capital Controls were re-tightened in 2006, they could allegedly include those who would be concerned only about political ideologies⁴⁵² and even manipulate the enforcement of the Capital Controls to enhance re-election prospects.⁴⁵³ Actually, there is very little evidence regarding such an unstated goal that

⁴⁴⁸ KAO, *supra* note 317, at 148.

⁴⁴⁹ Tung, *supra* note 266, at 15-16.

⁴⁵⁰ *See id.* at 151.

⁴⁵¹ Chao-Chang Chou, *Quan Qiu Hua Dui Liang An Guan Xi Zhi Ying Xiang [Research on How the Globalization Affects the Relationship between Taiwan and Mainland China]*, 21 ZHENG XIU XUE BAO [J. CHENG SHIU UNIV.] 201, 219 (2008) (Taiwan).

⁴⁵² *See, e.g., Chao Guo Liang Qian Wan Min Gan Ke Ji Lei Qi Ye Deng Lu Zeng She Zheng Ce Mian Shen Cha [The Policy Review Will Be Conducted towards Investment in the Mainland Exceeding \$20 Million or Involving Sensitive Technology]*, XING DAO HUAN QIU WANG [SING TAO GLOBAL NETWORK] (Sing.), Mar. 23, 2006, http://www.singtaonet.com/global/taiwan/t20060323_172257.html (last visited Dec. 5, 2009) (pointing out that the re-tightening of the Capital Controls in 2006 might display the political character of the then-ruling party DPP—political ideologies took command).

⁴⁵³ *See, e.g., Mo-Yun Wang, Op-Ed., Zhong Da Tou Zi An Qi Dong Zheng Ce Xing Shen Cha [The Policy Review Is Undertaken towards Significant Investments in China]*, ZHONG GUO SHI BAO [CHINA TIMES] (Taiwan), Dec. 15, 2006, at A17 (arguing that the Policy Review introduced in the 2006 PMEL policy might be taken advantage of to affect elections).

some groups of Taiwanese firms would benefit from hindering others in making PRC investments by raising costs by requiring doing it via OFCs.

3.5 Are the Capital Controls Loosened Due to the Popular Support for Less National Security Concern and for More Economic Integration?

Some might propose that the Capital Controls were loosened because the popular support on national security grounds faded while the support for more economic integration with China grew. The following poll evidence might largely rule out this explanation.

After the pro-China KMT was at the helm in 2008 and the Capital Controls were later 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 had an inclination to go down, which, as Chen-Yuan Tung argued, indicated the failure of Chinese 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 told 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. Still, they expressed that more than 60% of Taiwanese stood for the open-door policy concerning cross-Strait economic integration through institutionalized negotiation.⁴⁵⁴ In

⁴⁵⁴ Chen-Yuan Tung, Op-Ed., *Liang An Zheng Ce Yao Zhu Ti Yao Kai Fang* [Both Taiwanese Sovereignty
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other words, popular support on national security ground is still maintained even though further economic integration is widely supported. Therefore, the fact that the politics changed in 2008 whereas the popular support for national security concern remained suggests that the jurisdictional competition, and not just underlying politics, had more to do with the shift of the Capital Controls. In another word, the Capital Controls were loosened not because the popular support on national security grounds decreased, but instead the lightening had much to do with the jurisdictional competition.

Some might further ask whether Taiwan can credibly commit to not reenact the Capital Controls if KMT loses next election. The following evidence might facilitate addressing this question.

First of all, according to the results of the polls discussed above, the mainstream of Taiwanese public opinion suggests that Taiwan's government should safeguard Taiwan's sovereignty and de facto independence while promoting cross-Strait open exchange.

Moreover, as Clough describes, since 1987,

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/2007Cti/2007Cti-News/2007Cti-News-Content/0,4521,11051401+112009060300350,00.html>. 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); 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).

Taiwan has evolved from authoritarian rule to a fully democratic system, with a popularly elected president and legislature. The [KMT], which governed China on the mainland and has governed Taiwan since its withdrawal from the mainland in 1949, finds its position as ruling party threatened by the rise of a popular opposition, the [DPP].⁴⁵⁵

As for Taiwan's prospective status and the political relationship with China, "[t]he KMT advocates the reunification of Taiwan with mainland China in the presumably distant future when the political system there has become democratic, but the DPP wants an independent Republic of Taiwan, which the PRC is determined to prevent, by the use of military force if necessary."⁴⁵⁶

Nevertheless, in regard to the economic relationship with China, both parties appear to keep changing their positions to cater to the mainstream of Taiwanese public opinion in different periods. In concrete terms, when President Lee of KMT ruled over Taiwan, as Tung notes,

Taiwan's government felt ill at ease having such a close economic relationship with its powerful political rival, in part because the island feared that the flood of investment and trade from Taiwan will make the island economically dependent on China, undermining Taiwan's de facto political independence. In fact, Taiwan's fear has been triggered and reinforced by the fact that Beijing explicitly considers cross-Strait economic relations to be an important source of political leverage against Taiwan. Beijing conducts cross-Strait economic exchange with two political strategies in mind: "*yi min bi guan*" [(utilizing the public to urge the official)] and "*yi shang wei zheng*" [(exploiting business to press politics)]. Taipei worries that, if asymmetric interdependence in China's favor emerges across the Strait, Beijing

⁴⁵⁵ RALPH N. CLOUGH, COOPERATION OR CONFLICT IN THE TAIWAN STRAIT?, at x (1999) (alteration in original).

⁴⁵⁶ *Id.*

might exploit China's economic leverage through the use of economic sanctions in order to achieve political goals.⁴⁵⁷

The above factor accounts for one of the important reasons for the Lee administration to impose the Capital Controls in 1997.

Although DPP explicitly favors “de jure” political independence, DPP leaders have moderated their rhetoric on Taiwan independence as prospects for DPP rule brightened in the presidential election in 2000. It is said that one of the significant reasons why President Chen of DPP won the presidential election in 2000 is that DPP, then taking seriously the contradiction created by the NHBP policy made by KMT and the imperative for Taiwan’s accession to WTO, kept its political views pragmatic and catered to the then mainstream of Taiwanese public opinion by advocating the reconsideration of the NHBP policy, which was indeed relaxed and replaced by the Chen administration with the more liberal PLEM policy in 2001.⁴⁵⁸ In 2008, one of the important reasons why President Ma of KMT won the presidential election was also to cater to the current mainstream of Taiwanese public opinion by advocating the substitution of the large-scale liberalization of the Capital Controls for the inflexible PMEL policy. Along this line, regardless of disparate positions on the political relationship with China, both DPP and KMT would be forced to be politically realistic about the economic relationship with China under the potential discipline of votes. Hence, even though the possibility that Taiwan might reenact the Capital Controls if KMT loses next election cannot be completely ruled out, it

⁴⁵⁷ Tung, *supra* note 442, at 138 (alteration in original).

⁴⁵⁸ Jeng-Liang Kuo, Op-Ed., *Tian Chuang Liang Hua—Ying Zao Xin Zhu Liu Min Jin Dang Yao Zheng Shi Zhong Guo* [Jeng-Liang Kuo: To Mould A New Mainstream, DPP Must Face Up to China], ZHONG GUO SHI BAO [CHINA TIMES] (Taiwan), June 22, 2009, available at <http://news.chinatimes.com/2007Cti/2007Cti-News/2007Cti-News-Content/0,4521,11051401+112009062200101,00.html>.

seems more unlikely given the happening progress of cross-Strait economic integration. Specifically, the political views of the party which would in the future defeat KMT in the next election would more likely be consistent with the above mainstream public opinion of cross-Strait economic relations. The Capital Controls, which would impede cross-Strait economic integration, would less likely be reenacted. That is, there is a higher likelihood that the party advocating the resurrection of the Capital Controls would be voted out.

3.6 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 Economy⁴⁵⁹, why did Taiwan and Hong Kong (as a competitor against 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 the Capital Controls?

First, from a historic perspective, Wu reports:

As the People's Republic of China resumed its exercise of sovereignty over Hong Kong in 1997, and subsequently over Macau in 1999, the idea of "One Country, Two Systems" advocated by Deng Xiao-ping has been applied to these two areas. China amended its constitution to provide the legal basis for the establishment of the Special Administrative Region (SAR) and thus made the Hong Kong Special

⁴⁵⁹ 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.

Administrative Region (HKSAR) and the Macau Special Administrative Region (Macau SAR) possible. Hong Kong Basic Law and Macau Basic Law were promulgated by National People's Congress in order to ensure the high degree of autonomy of these two SARs to remain unchanged in fifty years. These two Basic Laws are not only national laws of China, but they are also mini-constitutions of these two SARs.⁴⁶⁰

On the other hand, “the government of the Republic of China (ROC) on Taiwan . . . has [been resisting] political linkage to the mainland in the form of PRC proposals to make Taiwan a special administrative region of the PRC, similar to Hong Kong but with a higher degree of autonomy.”⁴⁶¹ Hence, Hong Kong, after all, is part of the Chinese regime; however, Taiwan is outside Chinese jurisdiction.

Second, as Clough puts it in terms of the cross-Strait political antagonism,

[t]he two governments [(the ROC and the PRC)] have battled each other fiercely in the international arena, with the PRC insisting on the exclusive right to represent China, including Taiwan, in the world community and the ROC maintaining, as a sovereign political entity, that has never been a part of or been controlled by the PRC, it has the right to its own diplomatic and official relations with other countries. A trip made by President Lee Teng-hui to the United States, in an effort to enhance the ROC's international image, triggered the PRC's military reaction—a serious warning to the United States and Taiwan that it would not tolerate an independent state of Taiwan.⁴⁶²

The 1995-1996 Taiwan Strait tensions illustrate that China did not recognize Taiwan as an independent sovereign political entity and has been intimidating it with political and

⁴⁶⁰ Chien-Huei Wu, *One Country, Two Systems, and Three Memberships: Legal and Economic Integration between China and its Two SARs*, GLOBAL JURIST Vol. 7, Issue 3 (Advances), Art. 7., 1 (2007), available at <http://www.bepress.com/gj/vol7/iss3/art7>.

⁴⁶¹ CLOUGH, *supra* note 455, at ix (alteration in original).

⁴⁶² *Id.* at ix-x (alteration in original).

military forces. This political antagonism accentuated between 1995 and 1996 contributed to the imposition of the Capital Controls especially as a response to Chinese military intimidation. On the contrary, Hong Kong is subordinate to Chinese authority after re-integrated back to China in 1997. Therefore Hong Kong and China have been one country since then. It is impossible that Hong Kong would impose some restrictions similar to the Capital Controls (which is surely not allowed by China).

Third, China elected to preserve the Hong Kong law by promoting “one country, two systems” policy, and then opened its door wide open to Hong Kong corporations through the Closer Economic Partnership Agreement (CEPA, which can be seen as a Free Trade Agreement) signed in 2003.⁴⁶³ The signing of CEPA is proved a catalyst for the recent economic upspring in Hong Kong. In essence, CEPA virtually eliminates all barriers between China and Hong Kong in import/export, business incorporation, and physical movement. Thus for an FDI, they can enjoy the protection and convenience of the Hong Kong laws simply by incorporation in Hong Kong, while not losing any access to the Chinese Market. As a result, CEPA dramatically enhanced Hong Kong’s ability to attract FDIs, because only qualified Hong Kong companies can enjoy these benefits. Through CEPA, Hong Kong wholly embraced Mainland China’s market surely without any national security concern, not to mention the imposition of the investment restrictions like the Capital Controls on national security grounds.

⁴⁶³ Wu, *supra* note 460, at 1.

CHAPTER 4: CONCLUSION AND IMPLICATIONS

The Taiwanese government has encountered a dilemma of relaxing the Capital Controls while avoiding boosting the Mainland economy at Taiwan's own expense. While 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."⁴⁶⁴ 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."⁴⁶⁵ 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 causal 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 good legal rules and regulations.⁴⁶⁶

⁴⁶⁴ Sutter, *supra* note 331, at 522.

⁴⁶⁵ *Id.* at 523.

⁴⁶⁶ Rafael La Porta, Florencio Lopez de Silanes & Andrei Shleifer, *The Economic Consequences of Legal Origins*, 46 J. ECON. LITERATURE 285, 327 (2008).

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 are interactions of 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 excessive regulation while voice rights are taken advantage of in the domestic political process. In the Taiwan case, under economic globalization business demands, via economic and political agents, respond to excessiveness 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 somewhat differently, the general demand and supply forces underlying international jurisdictional competition stimulated by Taiwan-invested firms' business demands for global division of labor as well as for concomitant legal flexibility galvanize the gradual liberalization of the Capital Controls as international jurisdictional competition underlying globalization impairs regulatory capacity of Taiwan's government.

When the ASE's delisting attempt possibly spurred a tendency that Taiwanese companies listed in TWSE followed suit, Chun-Chi Shih, the then FSC chairman, at that time expressed that the ASE case gave rise to a crucial implication that even though many restrictions are imposed on economic transactions and capital markets, these restrictions might eventually be bypassed in a country with unfettered capital mobility, and that when it comes to restrictions on capital markets, we should rethink which restrictions are

justified.⁴⁶⁷ Furthermore, Joseph Jaushieh Wu, a former Chairperson of MAC (the primary regulatory agency of Taiwan's government regarding cross-Strait affairs) during President Chen's second term of presidency, helped the Chen administration make the regulatory transition from the more liberal PLEM policy to the severer PMEL policy in 2006. However, in the commendatory praise for Cheng-Yuan Tung's *The East Asian Economic Integration Regime and Taiwan's Strategy*, he conceded that Taiwan's economy has already been so open and liberalized that the government played a very limited role in dealing with the cross-Strait economic relations, that although the regulation seemingly prevented some industries from investing in China in instances of the initial imposition of NHBP by President Ten-Hui Lee's administration in 1997 as well as the re-tightening of regulation when President Shui-Bian Chen's government replaced PLEM with PMEL in 2006, many enterprises kept breaking through the blockade as they were directed in line with market forces to seek profits by various evasive ways, that is, circuitously transferring Taiwanese funds to China for investments, and that it was often found from the perspective of governmental regulation that the effect of regulation was really restrained.⁴⁶⁸

Moreover, the UMC criminal case of prosecution followed by MOEA's administrative fine in 2006 but later acquittal, plus the fact that the judiciary let UMC off with MOEA's fine as discussed in Chapter 3.A.1.2.2.2, could exemplify that the denationalization of financial capital under globalization might first galvanize

⁴⁶⁷ Yi-Xian Chen, *Shih Chun-Chi: Gang Gua Pai Tai Shang Ke Wang Hui Tai Fa TDR* [*Chun-Chi Shih: It's Expected That Taiwanese Firms Listed in Hong Kong Will Be Allowed to Issue TDRs Home*], ZHONG GUO SHI BAO [CHINA TIMES] (Taiwan), Dec. 5, 2006, available at <http://news.chinatimes.com/Chinatimes/newslist/newslist-content-forprint/0,4066,110507=11> (last visited Dec. 5, 2006).

⁴⁶⁸ TUNG, *supra* note 352, at xv.

international jurisdictional competition, which rendered barely effective the “management” (or regulatory) element of the Capital Controls, that the regulation could hardly impede market forces as people may vote with their feet, and that “the market decides all the things.”⁴⁶⁹ Just as Prof. Morriss points out, “[t]here is widespread agreement with Eichengreen’s assessment of the impact of global capital flows as a disciplinary force”⁴⁷⁰ That is, as Hampton and Abbott note, “[t]he sheer amount of capital residing in or passing through OFCs and tax havens is now so great that it is beyond the ability of any single government to—in Mrs. Thatcher’s famous words—‘buck the market.’”⁴⁷¹

⁴⁶⁹ UMC, *supra* note 278. Eventually, it might be market forces, or rather business demands, that all the same pushed Taiwan’s government to legalize UMC’s investment in Hejian to an extent. Kwong reports:

Taipei on Wednesday [February 10, 2010] unveiled a raft of rules that will relax investment into China by Taiwanese companies, particularly those in the flat panel and semiconductor industries. . . . The change makes legal long-delayed acquisitions in China by Taiwan Semiconductor Manufacturing Company and United Microelectronics Corporation, the world’s top two contract chipmakers. After a long and tumultuous saga that saw UMC fined T\$ 5m (US\$155,000m) for illegal investments in China in 2006, UMC said last April that it planned to buy the 85 per cent of Chinese chipmaker Hejian it does not already own. . . . Neither company had been able to complete their transactions because they were forbidden by Taiwan law until Wednesday. Shih Yen-Shiang, minister of economics affairs, said *the new rules were aimed, “to put it bluntly, at the acquisition plans of TSMC and UMC.”* It has been three years since Taiwan last reviewed its rules on China investment, he said, and “in those three years the world has changed a lot . . . we cannot remain still amid all the changes”.

Robin Kwong, *Taiwan Eases Law on China Investments*, FIN. TIMES, Feb. 11, 2010, available at http://www.ft.com/cms/s/0/6a3cd540-169c-11df-aa09-00144feab49a.html?nclick_check=1 (alteration in original) (emphasis added). From the perspective of jurisdictional competition among global legal centers, Shih’s quotation “in those three years the world has changed a lot . . . we cannot remain still amid all the changes” resonates, once again, with the positive or descriptive angle of Romano’s argument on jurisdictional competition in the U.S. corporate case:

Regulatory competition offers an advantage over a single regulator because it provides regulators with incentives and the necessary information to be accountable and responsive to the demands of the regulated. That is because there is a feedback mechanism in a competitive system that indicates to decisionmakers when a regime need to be adapted and penalized them when they fail to respond: the flows of firms out of regimes that are antiquated and into regimes that are not. This is an important regulatory characteristic in the corporate context, *because firms operate in a changing business environment, and their regulatory needs concomitantly change over time.*

Romano, *supra* note 102, at 1598-99 (emphasis added).

⁴⁷⁰ Morriss, *supra* note 365, at 51.

⁴⁷¹ Mark P. Hampton & Jason P. Abbott, *The Rise (and Fall?) of Offshore Finance in the Global Economy*:

Hence, as far as how to regulate firms is concerned, as Prof. Romano notes in recognizing the effect of jurisdictional competition,

[a] more useful way to characterize the connection between politics and economic organizational form, particularly in the contractual context of business organization, is to recognize that private parties are persistent in devising institutions that circumvent or minimize the effect of political constraints on economic development. The genius of American corporate law in this regard is that the dynamics of state competition reduces the number of extraneous regulations that must be bypassed.⁴⁷²

Further, adjusting the focus from jurisdictional competition within federal systems to that on the national level, Prof. Ribstein explains how to regulate firms not least under globalization:

The analysis of the international implications of Sarbanes-Oxley illustrates the extent to which international securities markets force regulators to think beyond national boundaries. . . . The mobility of capital means that any regulation is subject to being tested as firms reject bad or unsuitable laws and seek to be subject to good ones. This gives regulators both valuable information about which laws work, and incentives to meet market demand.⁴⁷³

The transitional trajectories of Taiwan's Capital Controls illustrate that international jurisdictional competition constrains such a democratically-constrained onshore jurisdiction as Taiwan from disregarding business demands and from imposing excessive regulation, in the sense that it is globalized markets, rather than parochial laws, that do

Editor's Introduction, in OFFSHORE FINANCIAL CENTERS AND TAX HAVENS: THE RISE OF GLOBAL CAPITAL 1, 13 (Mark P. Hampton & Jason P. Abbott ed., 1999).

⁴⁷² ROMANO, *supra* note 71, at 147. See also RICHARD TILLY, FINANCIAL INSTITUTIONS AND INDUSTRIALIZATION IN THE RHINELAND, 1815-1870 (1966).

⁴⁷³ Ribstein, *supra* note 115, at 327.

“regulate” economic activity across borders.⁴⁷⁴ Through this dissertation, regulatory jurisdictions similar to Taiwan 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. Exactly as Butler and Ribstein emphasize in the SOX case, this understanding “would involve regulators appreciating the significant limitations on government’s ability . . . to anticipate the full consequences of regulation.”⁴⁷⁵ This, meanwhile, reminds Taiwan’s government in the future that if regulating jurisdictions refuse to recognize business demands backed by economic globalization, firms have incentives and ability to seek out more cost-justified and flexible laws worldwide.

⁴⁷⁴ Tung, *supra* note 359, 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).

⁴⁷⁵ BUTLER & RIBSTEIN, *supra* note 109, at 96.

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APPENDIX A: TABLES

Table 1 Characteristics of ADR Programs⁴⁷⁶

	Level I	Level II	Level III	Level IV (Rule 144A)
Primary exchange	OTC “Pink Sheets”	NYSE, AMEX or NASDAQ	NYSE, AMEX or NASDAQ	PORTAL
Accounting standards	Home Country Standards	U.S. GAAP	U.S. GAAP	Home Country Standards
SEC registration	Exempt	Full Registration	Full Registration	Exempt
Share issuance	Existing shares only (public offering)	Existing shares only (public offering)	New equity capital raised (public offering)	New equity capital raised (private offering)
Time to completion	10 weeks	10 weeks	14 weeks	16 days
Costs	≤ \$25,000	\$200,000-700,000	\$500,000-2,000,000	\$250,000-5000,000

Source: THE BANK OF NEW YORK, GLOBAL OFFERINGS OF DEPOSITARY RECEIPTS, A TRANSACTION GUIDE (1995).

⁴⁷⁶ Darius P. Miller, *The Market Reaction to International Cross-listings: Evidence from Depositary Receipts*, 51 J. FIN. ECON. 103, 107 (1999) (Table 1 is herefrom cited).

Table 2 TDI in China (Comparison between the Statistics of Taiwan and China)

Year	Taiwan's Statistics		China's Statistics	
	Cases	Amount (\$ million)	Cases	Amount (\$ million)
1991 and before	237	174	3,446	2,783
1992	264	247	6,430	5,543
1993	1,262 (8,067) ⁴⁷⁷	1,140 (2,028)	10,948	9,965
1994	934	962	6,247	5,395
1995	490	1,093	4,778	5,777
1996	383	1,229	3,184	5,141
1997	728 (7,997)	1,615 (2,720)	3,014	2,814
1998	641 (643)	1,519 (515)	2,970	2,982
1999	488	1,253	2,499	3,374
2000	341	1,102	1,399	1,984
Total	22,475	15,598	44,915	45,758

Source: Chen & Chu, *supra* note 182, at 219.

Note: Statistics are up to June 2000 only.

⁴⁷⁷ Numbers in parentheses are investment projects recorded through make-up registration, as discussed in Chapter 3.A.1.2.2.2; they were not approved by MOEA in advance.

Table 3 TDI in China (Taiwan's Statistics)

Year	Taiwan's Statistics	
	Cases	Amount (\$ million)
1991	237	174
1992	264	247
1993	1,262 (8,067) ⁴⁷⁸	1,140 (2,028,046)
1994	934	962
1995	490	1,092
1996	383	1,229
1997	728 (7,997)	1,615 (2,720)
1998	641 (643)	1,519 (515)
1999	488	1,253
2000	840	2,607
2001	1,186	2,784
2002	1490 (1,626)	3,859 (2,864)
2003	1,837 (2,038)	4,595 (3,104)
2004	2,004	6,941
2005	1,297	6007
2006	1,090	7,642
2007	996	9,971
2008	482 (161)	9,843 (848)
From 1991 to Dec. 2008 ⁴⁷⁹	37,181	75,560

Source: INVESTMENT COMMISSION, MINISTRY OF ECONOMIC AFFAIRS, MONTHLY STATISTIC REPORT ON OVERSEAS CHINESE & FOREIGN INVESTMENT, OUTWARD INVESTMENT, MAINLAND CHINA INVESTMENT (Feb. 2009), <http://www.moeaic.gov.tw/> (last visited Mar. 15, 2009).

Note: Statistics are up to December 2008.

⁴⁷⁸ Numbers in parentheses are investment projects recorded through make-up registration rather than prior approval.

⁴⁷⁹ The number of cases and amount in this row include those of previously unregistered investments which are recorded through make-up registration.

Table 4 Taiwan Approved Outward Investment by Country (Area)

Period	1991-2007			Jan.-Apr. 2008			Accumulative Total		
Area	Cases	Amount(\$ million)	Percentage by Amount (%)	Cases	Amount(\$ million)	Percentage by Amount (%)	Cases	Amount(\$ million)	Percentage by Amount (%)
Mainland China	36,538	64,869.07	55.40	257	2,946.26	61.44	36,795	67,815.32	55.64
British Central America	1,881	20,028.35	17.10	28	577.67	12.05	1,909	20,606.02	16.91
USA	4,583	8,975.51	7.67	19	135.34	2.82	4,602	9,110.85	7.47
Singapore	400	4,671.50	3.99	4	629.73	13.13	404	5,301.24	4.35
Hong Kong	912	2,672.93	2.28	13	35.33	0.74	925	2,708.26	2.22
Vietnam	348	1,462.36	1.25	8	96.86	2.02	356	1,559.22	1.28
Panama	58	1,178.66	1.01	0	0.00	0.00	58	1,178.66	0.97
Japan	427	1,120.99	0.96	11	23.99	0.50	438	1,144.98	0.94
Thailand	274	1,703.98	1.46	1	3.61	0.08	275	1,707.58	1.40
Philippines	123	512.29	0.44	1	1.36	0.03	124	513.65	0.42
Korea	129	250.73	0.21	2	229.01	4.78	131	479.74	0.39
Germany	130	140.86	0.12	3	7.01	0.15	133	147.88	0.12
Others	1,827	9,506.49	8.11	34	109.36	2.26	1,861	9,615.85	7.89
Total	47,630	#####	100.00	381	4,795.54	100.00	48,011	121,889.25	100.00

Source: MAINLAND AFFAIRS COUNCIL, CROSS-STRAIT ECONOMIC STATISTICS MONTHLY NO.185, at 31 (May 2008), available at <http://www.mac.gov.tw/big5/statistic/em/185/13.pdf>.

Table 5 Comparison and Evaluation regarding Listing Advantages among TWSE, HKSE and the U.S. Stock Exchanges⁴⁸⁰

Evaluation Indices	Taiwan	Hong Kong	The U.S.
Stock Exchange	TWSE	HKSE	NYSE and NASDAQ
Applicable Law	Taiwanese Law and Regulations	Hong Kong Law and Regulations	U.S. Securities Law and SEC regulations
Ease of Transferring Shares	Easy	Easy	Easy
Target Investors	Global Institutional Investors	Global Institutional Investors	Global Institutional Investors
Investor Protection	Medium	High	High
Forecast Institutional Liquidity	Medium	High	High
Forecast Retail Liquidity	High	High	Low
Scope of Research Coverage	Medium	High	High
Listing Requirements	Reasonable	Reasonable	Strict
Listing Cost and Expenditure	Medium	Medium	High
Disclosure Requirements	Reasonable	Reasonable	Strict
Visibility in International Markets	High	High	High
Options by Potential Investors	High	High	High

Source: JP MORGAN, EQUITY MARKETS OVERVIEW 21 (2005).

⁴⁸⁰ *Internationalization*, *supra* note 237, at 28 (Table 5 is herefrom cited).

Table 6 The Capital Controls on Investment in Mainland China under the NHBP Policy

Type	Net worth or capital (whichever is higher)	Cap on accumulated amount of investments in China or on the percentage
1. Individuals and small- and medium-sized firms		The limit is NT\$60 million.
2. Private firms		Private firms' investment may not exceed 40% of net worth or capital (whichever is higher), or NT\$60 million, whichever is higher.
3. Listed firms	Firms with under NT\$5 billion	Their investments may not exceed 40% of their capital or net worth, whichever is higher.
	Firms with between NT\$5 billion and NT\$10 billion	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.
	Firms with over NT\$10 billion	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.

Source: Investment Commission, MOEA

Table 7 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
1. Individuals and small- and medium-sized firms		The limit is NT\$80 million.
2. Firms with over NT\$80 million in their paid-in capital	Firms with under NT\$5 billion	Their investments may not exceed 40% of their net worth or NT\$80 million, whichever is higher.
	Firms with between NT\$5 billion and NT\$10 billion	Their investments may not exceed 40% of NT\$5 billion plus 30% of the portion of their net worth over NT\$5 billion.
	Firms with over NT\$10 billion	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 over NT\$10 billion.

Source: Investment Commission, MOEA

Table 8 The Capital Controls on Investment in Mainland China since May 2008

Type	Cap on accumulated amount of investments in China or on the percentage
1. Individuals	The limit is relaxed to \$5 million for investments per year.
2. Small- and medium-sized firms	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.
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 headquarter in Taiwan, there will be no upper limit for such a firm.

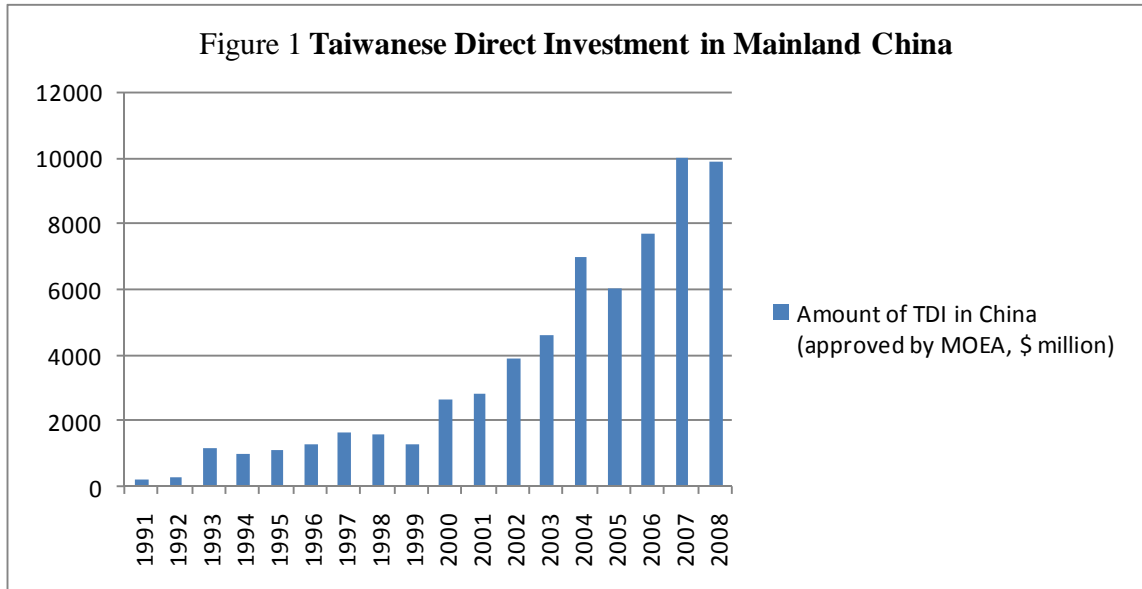
Source: Investment Commission, MOEA

Table 9 Taiwan's Investment in British Central America and BVI's Investment in China (1995-99)

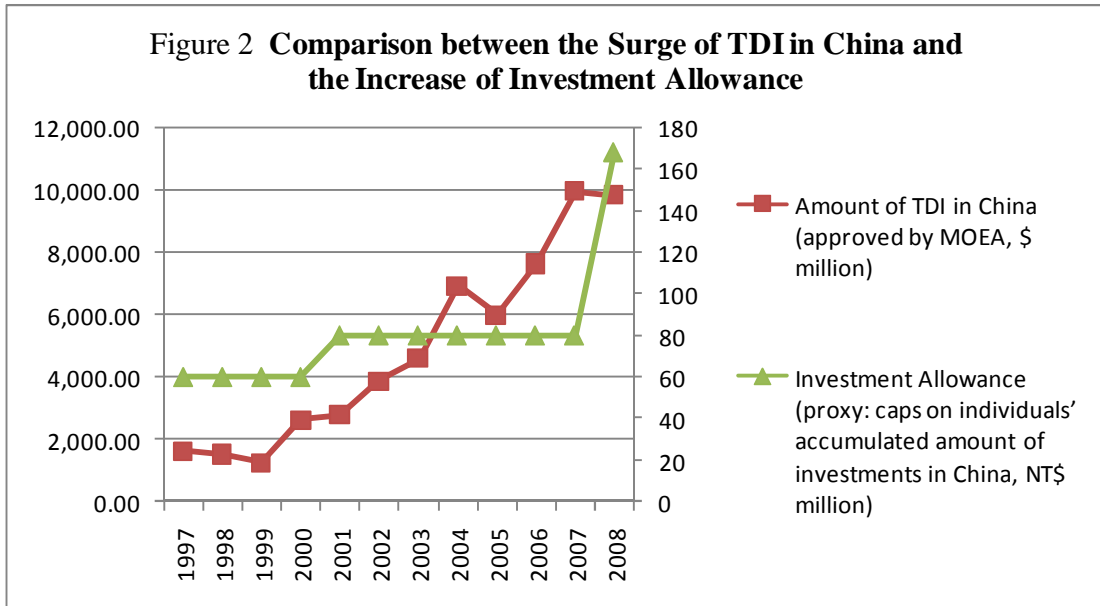
Year	Taiwan's Approved Outward Investment in British Central America (BVI and the Cayman Islands)		BVI's Outward Investment in China	
	Amount (\$ million)	Share of Taiwan's Total Outward FDI	Amount (\$ million)	Share of China's Total FDI Inflows
1995	370	15.1%	304	0.8%
1996	809	23.8%	538	1.3%
1997	1,051	23.3%	1,717	3.8%
1998	1,838	38.2%	4,031	8.9%
1999	1,360	30.1%	2,659	6.6%

Source: TUNG, *supra* note 359, at 26.

APPENDIX B: FIGURES

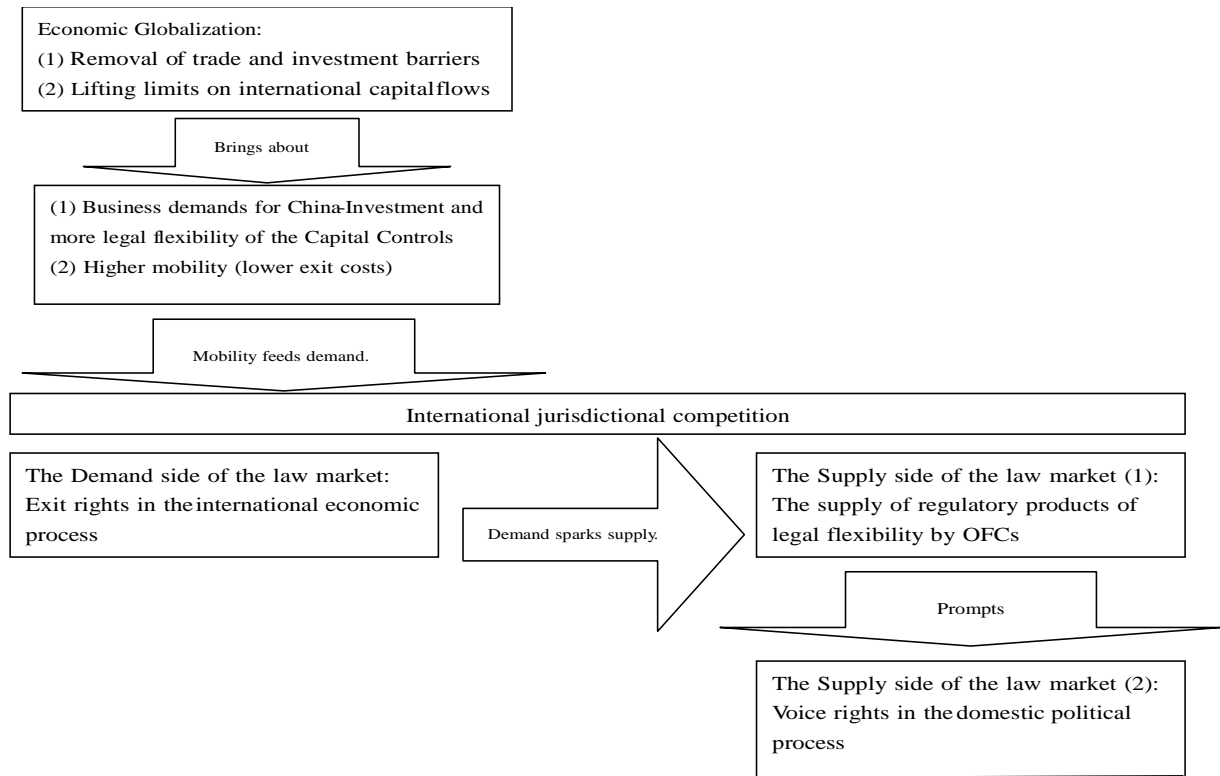


Source: INVESTMENT COMMISSION, MINISTRY OF ECONOMIC AFFAIRS, MONTHLY STATISTIC REPORT ON OVERSEAS CHINESE & FOREIGN INVESTMENT, OUTWARD INVESTMENT, MAINLAND CHINA INVESTMENT (Jan. 2009), <http://www.moeaic.gov.tw/> (last visited Mar. 13, 2009).



Source: This Author

Figure 3 The Function of the Jurisdictional Competition to Cause the Relaxation of Taiwan's Capital Controls



Source: This Author

AUTHOR'S BIOGRAPHY

Chang-hsien Tsai graduated from National Taiwan University College of Law (Taiwan) with an LL.B. degree in 2001 and a Master of Law degree in 2004. For several years Tsai practiced law in Taiwan before relocating to the United States, to pursue graduate study in law. He completed an LL.M. in Corporate Law degree from New York University in 2008. Following the completion of his JSD degree, Tsai will begin teaching as an assistant professor of law in Taiwan.