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Banking and Finance in Taiwan: The Prospects for Internationalization in the 1990s

The economic miracle achieved in recent decades by the Republic of China (ROC) on Taiwan¹ has received widespread attention.² Discussion of this development often focuses on Taiwan's program for export-oriented growth.³ Less attention has been directed to Taiwan's political system,⁴ and still less to Taiwan's banking system.⁵ Taiwan's success in export-driven economic growth has created pressure not only for political reform and democratization, but also for reform of the antiquated, unruly, and inadequate financial system.

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1. Following the victory of the Chinese Communist Party in 1949, the administration of the ROC was moved to Taiwan where it has remained. The ROC has never renounced its claim to be the sole legitimate government of all China, and so Taiwan views itself not as an independent country but as the largest region of China under control of the ROC today. In this article, however, references to Taiwan should be interpreted as references to the ROC on Taiwan.

2. See, e.g., R. HOFHEINZ, JR. & K. CALDER, *THE EAST ASIA EDGE* (1982); S.W.Y. KUO, G. RANIS & J.C.H. FEI, *THE TAIWAN SUCCESS STORY* (1981); K.T. LI, *THE EVOLUTION OF POLICY BEHIND TAIWAN'S DEVELOPMENT SUCCESS* (1988); T. GOLD, *STATE AND SOCIETY IN THE TAIWAN MIRACLE* (1986); R. WADE, *GOVERNING THE MARKET: ECONOMIC THEORY AND THE ROLE OF GOVERNMENT IN EAST ASIAN INDUSTRIALIZATION* (1990).

3. See, e.g., *THE POLITICAL ECONOMY OF THE NEW ASIAN INDUSTRIALISM* (F.C. Deyo ed. 1987).

4. "Work on political and social processes [in newly industrialized countries of Asia such as Taiwan], and how they related to economic processes, has hardly begun." Winckler & Greenhalgh, *Analytical Issues and Historical Episodes*, in *CONTENDING APPROACHES TO THE POLITICAL ECONOMY OF TAIWAN 3* (E. Winckler & S. Greenhalgh eds. 1988).

5. R. WADE, *supra* note 2, at 159. Such coverage as the ROC financial system has received has focused on economic or foreign investment perspectives, and so minimized the significance of cultural, historical, political, or social factors within the system. See, e.g., Wang & Yang, *Financial Institutions in Taiwan: An Analysis of the Regulatory Scheme*, 4 J. CHIN. L. 3 (1990); Liu, *Financial Developments and Foreign Investment Strategies in Taiwan—A Legal and Policy Perspective*, 25 INT'L LAW. 69 (1991).

The pressure for banking reform in the ROC has come from both inside and outside Taiwan. Until recently, ROC policy has been for the government to dominate the banking system, and for the banking system to dominate the financial system. ROC authorities tried to ignore demand from local investors for the right to compete freely with government-owned banks. For decades, lack of adequate financial services from regulated institutions has fostered the growth of a huge informal⁶ or underground financial system.⁷ Furthermore, demands from the United States for equal competitive opportunities in Taiwan for U.S. companies, including banks, insurance companies, and securities firms, has been a contentious issue between the two countries for years.⁸ If Taiwan's financial markets can be liberalized and internationalized, it will have a direct impact on U.S. banks, insurance companies, and brokerage firms either doing business or hoping to do business in Taiwan.

In recent years, the ROC government has been more receptive to external and internal pressures for reform of the domestic financial system.⁹ With increasing democratization of the government in Taiwan, it is likely that the government will be more responsive to popular demand for improved financial services. The ROC no longer enjoys diplomatic recognition from its major trading partners—the United States, Japan, and the European Community (EC)—but its ties to the international financial system are in some sense surrogates for diplomatic relations.¹⁰ Leaders in Taiwan seem to appreciate the importance of integrating Taiwan into the international financial system and have adopted policies to make Taiwan an East Asian international financial center in the decades to come.¹¹

6. "Informal economy" is defined as one that is unregulated by the institutions of society in a legal and social environment in which similar activities are regulated. Castells & Portes, *The World Underneath: The Origins, Dynamics, and Effects of the Informal Economy*, in *THE INFORMAL ECONOMY: STUDIES IN ADVANCED AND LESS DEVELOPED COUNTRIES* 12 (L. Portes, M. Castells & L. Benton eds. 1989).

7. This informal financial system includes loan sharks, underground investment houses, post-dated checks, builder's mortgages, intercorporate loans, family credit, neighborhood loan circles, and margin finance. Kaye, *Pains of Adolescence*, *FAR. E. ECON. REV.*, Jan. 25, 1990, at 51. See *infra* text section I.B. for a discussion of the informal financial system.

8. Kaplan, Russin, Vecchi & Parker, *National Treatment Issues Affecting Branches of Foreign Banks in the Republic of China on Taiwan* (June 8, 1984) [hereinafter Kaplan].

9. Kaye, *supra* note 7, at 50. In the last three years, ROC authorities have relinquished significant control over foreign exchange rates and interest rates; granted licenses to new securities broker/dealers; permitted direct foreign investment in the Taiwan Stock Exchange; permitted expanded foreign bank operations in the domestic market; permitted expanded foreign insurance company operations in the domestic market; begun the privatization of major government-owned commercial banks; and granted licenses to new privately-owned commercial banks. See *infra* text section III.

10. Chan, *The Mouse That Roared: Taiwan's Management of Trade Relations with the United States*, 20 *COMP. POL. STUD.* 251, 282–85 (1987). For a general discussion of the close relationship between private banking and national sovereignty issues, see generally B. COHEN, *IN WHOSE INTEREST?: INTERNATIONAL BANKING AND AMERICAN FOREIGN POLICY* (1986).

11. The ROC Act for Offshore Banking Operations was enacted on December 12, 1983, and established an offshore banking system. See *An Act for Offshore Banking Operations*, E. ASIAN EXEC. REP., May 15, 1984, at 23 (translated by Lee & Li). Offshore banking operations have been con-

Taiwan's leaders also work to avoid conflicts in relations with the United States, and have opened some local financial markets to competition from U.S. companies in response to threats of restricted access to U.S. markets.¹² Major reforms have recently been made in the ROC Banking Law and Securities and Exchange Law, and reforms of the Insurance Law are currently being discussed.

While this trend is encouraging, underlying institutional and political problems remain unsolved. These lurking structural problems may seriously impede current reforms, although they are not likely to frustrate completely reform efforts. Political problems include the slow, hesitant pace of democratic reform and the continuing domination of the national political agenda by the Nationalist Party, the Kuomintang (KMT).¹³ The KMT exercises wide powers outside the formal institutions of government and curtailing its ability to manipulate and frustrate what is ostensibly official government policy will require more than narrow reform of government institutions.¹⁴ At an institutional level, decades of inadequate financial services have created and sustained a massive informal financial system.¹⁵ Successive crises periodically arise in this informal sector which threaten to destabilize the entire financial system.¹⁶ While authorities tackled the crises as they arose, they have yet to address the root causes of the informal financial system. Until the financial system becomes more responsive to demand and until the ROC regulatory system operates with more authority, the informal financial system will remain a potential threat to the safety and soundness of banking and finance in Taiwan.

This article first sketches the existing institutional and regulatory framework within which banks and other financial institutions operate in Taiwan. The primary focus is on the banking industry, with some reference to developments in related financial sectors such as securities or insurance. Section II discusses the pressures from within and without Taiwan that encourage reform of the ROC banking system. Section III outlines recent changes in ROC law designed to implement official policies favoring liberalization and internationalization of the financial system. Section IV argues that the prospects for financial reform and

ducted on a small scale ever since. *Taiwan hopes to link call market with Singapore*, Reuters Money Rep., Oct. 15, 1990.

12. McGregor, *Taiwan Runs Giant U.S. Lobbying Effort to Preserve Vital Economic Relationship*, Asian Wall St. J. Weekly, Oct. 30, 1989, at 2.

13. *The Upcoming Elections in Taiwan: Hearing Before the Subcomm. on Asian and Pacific Affairs and the Report of the U.S. Cong. Observer Delegation to Taiwan of the House Comm. on Foreign Affairs*, 101st Cong., 1st Sess. 7 (1989) (statement of David W. Tsai, President, Center for Taiwan International Relations) [hereinafter *Election Hearings*].

14. N.T. Wu, *The Politics of A Regime Patronage System: Mobilization and Control within an Authoritarian Regime* 16 (1987) (unpublished Ph.D. thesis, University of Chicago).

15. R.H.C. Ho, *THE FINANCIAL SYSTEM IN TAIWAN, REPUBLIC OF CHINA: ITS FUNCTION AND OPERATION* 13 (1981).

16. The most notable recent examples are the Cathay scandal in 1985 and the phenomena of underground investment companies in the late 1980s. See *infra* notes 51–54, notes 74–78 and accompanying text.

internationalization are linked to the prospects for political reform in Taiwan. The ROC is entering a period of political transformation, the outcome of which will be uncertain for many years to come. If the reforms produce a multiparty democracy and a strong legal system like those of the United States, then the regulation of financial institutions in the ROC may be conducted primarily through the legal system. If the reforms produce democracy like that of Japan, in which one party persistently dominates and regulation takes place through informal bureaucratic mechanisms largely outside legal review, then the ROC legal system will play a smaller role in regulating financial institutions. The article concludes with the suggestion that bureaucratic informalism along the lines practiced in Japan is a more likely outcome in Taiwan than a highly legalistic regulatory system such as is found in the United States. If that proves correct, then liberalization and internationalization of banking and finance in Taiwan will likely remain superficial and only partially effective.

I. The Existing Legal and Institutional Framework

A. RECENT BACKGROUND TO CONTEMPORARY PROBLEMS IN BANKING REGULATION

Official ROC policies concerning the regulation of banks in Taiwan have been strongly influenced by historical events.¹⁷ The first modern Chinese commercial bank was established on mainland China in 1896.¹⁸ Until World War II, however, ROC regulation of banking in China was subject to considerable interference from foreign banks operating outside the control of Chinese authorities in the foreign concessions.¹⁹ After World War II, civil war and hyperinflation impeded the development of a sound financial system in China.²⁰ Taiwan was a Japanese colony from 1895 until 1945 when it was retroceded to China and came under KMT control. Following the KMT's defeat on mainland China and its retreat to Taiwan in 1949, the KMT focused its domestic policy on taming inflation and achieving economic survival.²¹

Fearing a loss of autonomy in national financial and economic policies, the KMT has not allowed foreign banks free access to domestic financial markets,

17. STAFF STUDY PREPARED FOR THE USE OF THE JOINT ECON. COMM., RESTORING INTERNATIONAL BALANCE: THE TAIWAN ECONOMY AND INTERNATIONAL TRADE, S. REP. NO. 59, 100th Cong., 1st Sess., at 22 (1987) [hereinafter S. REP. NO. 59]. See also K. Fields, *Developmental Capitalism and Industrial Organization: Business Groups and the State in Korea and Taiwan* (unpublished Ph.D. thesis, University of California at Berkeley 1990, at 147).

18. This was the Imperial Bank of China, which no longer exists. PEAT, MARWICK, *BANKING IN TAIWAN* 3 (1986). The oldest modern Chinese bank still in existence is the International Commercial Bank of China, organized in 1907 as the Ta Ch'ing Bank.

19. T.H.S. Wan, *Internationalization and Modernization of Banking in the Republic of China* (unpublished Ph.D. thesis, Queen Mary/Westfield College, University of London, expected submission, 1992).

20. S.P.S. HO, *ECONOMIC DEVELOPMENT OF TAIWAN, 1860-1970*, at 104 (1978).

21. K.T. LI, *supra* note 2, at 39.

nor has it allowed direct foreign competition directly with local banks in providing most services. Rather, foreign bank participation in the domestic market has been limited to filling the gaps left by local banks. Even though such participation is potentially profitable,²² the authorized scope of business of foreign banks in Taiwan remains restricted by regulations.²³

The KMT strategy of rigid, conservative financial policies combined with highly intrusive government regulation of banks, including the allocation of credit to foster economic development and political alliances, has its origins in the hyperinflation of the 1940s. As the KMT's control over China's fiscal resources eroded during the civil war preceding the KMT defeat by the Communists in 1949, the KMT regime was forced to rely on inflationary note issue to finance its operations. KMT leaders believed that inflation, which rose to a 3,000 percent annual rate in 1949, contributed decisively to their defeat on the mainland. After their retreat to Taiwan, KMT leaders implemented stringent anti-inflation policies, and resolved never to lose control of ROC financial institutions and resources again.²⁴

The conservatism of ROC financial policy may be justified by references to a desire to maintain the safety and soundness of the banking system, but such an explanation fails to address the fundamental paradox of financial regulation in Taiwan. This highly intrusive and oppressive regulation of banks has been accompanied by an apparent disregard for the growth of the informal financial system.²⁵ Safety and soundness has therefore not been the primary concern of regulators, nor has facilitating a free flow of credit to the small and medium-sized businesses that have been the backbone of Taiwan's development.²⁶ Taiwan's economic miracle has been achieved as much in spite of as because of its financial system. The system has provided a limited quantity of credit on pref-

22. In fact, foreign bank operations in Taiwan are not always profitable. Foreign banks in Taiwan heavily involved in extending credit in the early 1980s sustained heavy losses during the recession that lasted from 1982–1985. Many have curtailed their lending operations in favor of fee-based services, or left Taiwan altogether. Because foreign banks have very restricted access to the consumer banking services market in Taiwan, foreign banks do not have many options to diversify beyond commercial lending and fee-based services. See Mark & Owens, *Taiwan's Market Losing Its Appeal for Foreign Banks*, Asian Wall St. J. Weekly, Sept. 10, 1990, at 1.

23. *Implementation of the Taiwan Relations Act: Hearing and Markup Before the H.R. Comm. on Foreign Aff. and Its Subcomm. on Human Rights and Int'l Organizations and on Asian and Pacific Affairs*, 99th Cong., 2d Sess. 10 (1986) (statement of David Dean, director, American Institute in Taiwan); ORG. FOR ECONOMIC COOPERATION & DEV., FINANCIAL SYSTEMS AND FINANCIAL REGULATION IN DYNAMIC ASIAN ECONOMIES (1990) [hereinafter OECD].

24. R. WADE, *supra* note 2, at 167; K. Fields, *supra* note 17, at 147.

25. Kaye, *supra* note 7, at 50.

26. Taiwan's private sector is composed almost entirely of small, light industrial and trading firms which are thinly capitalized, with fewer than 50 employees and less than U.S. \$1.5 million in annual sales. These businesses are largely self-financed, or financed through family networks. Because of the caution shown by major lenders, leverage is not high.

Although the island economy has boomed since the early 1960s, there has been relatively little consolidation of small firms into larger ones. Mergers are rare in Taiwan, as are bankruptcies, and there is a strong tendency for small firms to persist and grow modestly over time.

S. REP. NO. 59, *supra* note 17, at 10.

erential terms for designated recipients, such as government-owned enterprises, while the majority of businesses were left to fend for themselves in informal credit markets.²⁷

Authorities originally tolerated the growth of informal financial institutions because credit from regulated sources was manifestly inadequate to meet the needs of Taiwan's booming economy. Since the mid-1980s, however, conditions in Taiwan's financial markets have changed dramatically. A chronic credit shortage was supplanted by excess liquidity and wild speculation in the stock market, in real estate, in underground investment companies, and even in an underground futures market.²⁸ Strong export sales combined with a declining rate of local investment to create cash balances in excess of opportunities for investment and a higher level of national foreign exchange reserves than any country in the world except Japan. Efforts by regulators to stem the tide of speculation were largely ineffective, in part because the entrenched informal financial system now defied simple attempts at regulation.²⁹

B. BANKS AND OTHER FINANCIAL INSTITUTIONS

Banks dominate the financial system of Taiwan and dwarf other participants in terms of the volume of financial assets handled.³⁰ In addition to the banking system (in which foreign banks have been allowed to play a limited but important role), the financial system of Taiwan includes bills finance houses, trust and investment companies, insurance companies, a stock exchange, and the informal financial system. The most developed institutions, such as banks, the money market, and the informal financial system, deal with short- and medium-term credit. Institutions for long-term credit and investment are less developed or, like

27. *Id.*; Winn, *Taiwan Ends Penalties for Bad Checks in Move to Reform Its Financial System*, E. ASIAN EXEC. REP., Aug. 15, 1986, at 9.

28. From 1987 to 1989, futures trading was a popular form of gambling in Taiwan. Underground futures traders operated as bookmakers, taking bets from the public and then paying out based on price fluctuations in organized futures markets in Japan and the United States. Regulations aimed at cleaning up futures trading in Taiwan will not establish a local futures exchange, but will seek to guarantee that customers' orders are actually transmitted to the foreign exchanges where the price quotes originate. McGregor, *Taiwan Taking Steps to Bring Legitimacy to Futures Industry*, Asian Wall St. J. Weekly, Dec. 19, 1990, at 1.

29. For example, in 1989, Finance Minister Shirley Kuo tried to curb rampant speculation on the Taiwan Stock Exchange by introducing a tax on stock transactions (both purchases and sales), but was forced to reduce the tax to nominal levels in the face of strong public protest. Moore, *High-Stakes Shakeout*, FAR E. ECON. REV., DEC. 14, 1989, at 114. Following the tax policy turnaround, the stock market continued to climb until it hit a high of 12,495.34 on February 10, 1990.

30. In 1980, banks accounted for 75 percent of all financial claims, while nonbank financial institutions (such as trust and investment companies, bills finance houses, insurance companies) accounted for only 7 percent. Corporate stock accounted for only 13 percent while government and private bonds, notes, and bills accounted for 6 percent. R. WADE, *supra* note 2, at 159. In 1991, however, there has been a dramatic increase in the number of government bonds issued as the ROC government embarks on a major program of development projects. Baum, *Paper Chase*, FAR E. ECON. REV., July 25, 1991, at 45.

the stock market, are dominated by speculators and provide little assistance to most businesses. Conservative fiscal policies to prevent government deficits have hindered the development of a government bond market.³¹ Long-term savings vehicles such as life insurance and pension plans are not well accepted by a public that, until recently at least, relied on extended families to provide financial security during hard times or old age.³² Although the stock market is well established, insider trading is rampant. Most local investors are animated by speculative motives and do not hold investments long-term.

The major commercial banks in Taiwan are also licensed to act as savings banks (which have the power to underwrite securities) and operate trust departments, creating the possibility of "universal" banking similar to that developed in Germany, although this possibility has not been realized.³³ These banks have the power to take deposits, make loans, discount bills and notes, issue letters of credit, invest in bonds, and underwrite securities.³⁴ Various governmental units still controlled the major commercial banks operating in Taiwan in 1990.³⁵ In addition, three privately-owned commercial banks³⁶ were operating in 1990, as well as thirty-seven foreign bank branches and eighteen foreign bank representative offices.³⁷

31. OECD, *supra* note 23.

32. Shea, *Financial Development in Taiwan: A Macro Analysis*, in *THE ROLE OF FINANCE IN ECONOMIC GROWTH AND DEVELOPMENT: JAPAN, KOREA & TAIWAN* (H. Patrick & Y.C. Park eds., forthcoming).

33. R. WADE, *supra* note 2, at 264; BANKING COMMITTEE, AMERICAN CHAMBER OF COMMERCE IN THE REPUBLIC OF CHINA, *FINANCIAL SERVICES REFORM IN THE REPUBLIC OF CHINA ON TAIWAN 2* (1987); see also J. ZYSMAN, *GOVERNMENTS, MARKETS AND GROWTH* 261 (1983).

34. Banking Law art. 71 (as amended July 17, 1989) provides that a commercial bank may: accept checking, demand, and time deposits; extend short- and medium-term loans; discount bills and notes; invest in bonds and notes; handle remittances; accept drafts and issue letters of credit; provide guarantees; act as collecting and paying agent; act as agent in the sale of government and corporate stocks and bonds; conduct warehousing, custody, and agency business in relation to authorized activities; and also conduct other business if so authorized. Article 78 of the Banking law provides that a savings bank may provide many of the same services, although deposit taking is limited to savings, time, and demand deposits; savings banks are also authorized to underwrite government or corporate securities.

35. Banks controlled by the central government include the Central Bank of China, the Bank of Communications, the Central Trust of China, the Farmers Bank of China, and the Export-Import Bank of the Republic of China. The commercial banks controlled by the Taiwan provincial government include the Chang Hwa Commercial Bank, the Hua Nan Commercial Bank, and the First Commercial Bank. The provincial government also controls the Land Bank of Taiwan, the Bank of Taiwan, the Medium Business Bank of Taiwan, and Cooperative Bank of Taiwan. PEAT, MARWICK, *supra* note 18, at 4. The International Commercial Bank of China is controlled by the KMT. Kaplan, *supra* note 8, at 5.

36. They are the Overseas Chinese Commercial Banking Corporation, The Shanghai Commercial & Savings Bank, Ltd., and the United World Chinese Commercial Bank. These banks are run by overseas Chinese with close connections to the KMT. Friedland, *Law for the Jungle: New Legislation to Improve Banking Services*, FAR E. ECON. REV., Jan. 25, 1990, at 52. In addition, there are eight small and medium-sized enterprise banks. CENT. BANK OF CHINA, *FINANCIAL INSTITUTIONS IN TAIWAN, THE REPUBLIC OF CHINA* 13 (1984).

37. Mark & Owens, *Taiwan's Market Losing Its Appeal for Foreign Bankers*, *supra* note 22, at 1.

In addition to the major commercial banks, Taiwan has various types of special purpose banks. The Central Bank of China (CBC) acts as a bank to other governmental units, regulates banks in cooperation with the Ministry of Finance (MOF), and oversees exchange rate markets. Other special purpose banks include development banks, such as the Bank of Communications and the Export-Import Bank of China; credit cooperatives; and credit departments in farmers' and fishermen's associations. Additionally, eight small and medium-sized enterprise banks provide financial services within a limited geographical region.³⁸

Banks compete with bills finance houses to provide working capital to businesses through the organized money market. ROC authorities established three bills finance houses in the 1970s in response to growing official perception that the informal money market was large enough to threaten the stability of the financial system generally. These bills finance houses assist in the issuance of notes and bills by borrowers and help sustain an active secondary market for them.³⁹ The ROC authorities exercise effective control over the bills finance houses because their majority shareholders are government-owned banks.⁴⁰

Banks compete with trust and investment companies in markets for long-term savings and credit. The MOF licensed seven privately-owned trust companies following adoption of a government policy in 1971 to promote the development of these companies.⁴¹ Trust companies are not supposed to accept deposits from the public, but rather are to accept long-term trust funds. Trust companies were originally licensed to help develop fiduciary services in Taiwan and expand underdeveloped markets for long-term financial investments by promoting investment in securities and real estate for trusts and pensions.

The insurance industry in Taiwan has already made substantial progress toward internationalization. The local insurance industry has long suffered from a poor reputation with the public due to unsophisticated or unsound management and investment policies.⁴² In 1985, ROC authorities agreed to admit U.S. in-

38. CENT. BANK OF CHINA, *supra* note 36.

39. PEAT, MARWICK, *supra* note 18, at 6.

40. U.S. DEP'T OF TREASURY, NATIONAL TREATMENT STUDY 309 (1990).

41. The Ministry of Finance promulgated the "Rules Governing Trust and Investment Companies" and "Criteria Governing Establishment of Trust and Investment Companies" on November 30, 1970. Seven trust companies were licensed under these regulations. The China Development Company, established in 1959, is also considered a trust company. CENT. BANK OF CHINA, *supra* note 36, at 17.

The Banking Law has contained provisions governing trust business since it was promulgated in 1931. Banking Law arts. 29-33 (as amended through Mar. 28, 1931). The concept of trust, however, is a foreign concept not well recognized in ROC law. Until special regulations were issued in 1971, ROC authorities were apparently unwilling to encourage the development of trust business among financial institutions.

42. ROC officials licensed a large number of local insurance companies in 1960, but the track record of many of the companies then licensed was unsatisfactory. No further licenses were granted until U.S. companies put pressure on the ROC authorities in the 1980s. Local companies had a bad reputation with the public for employing unprofessional, unreliable sales representatives and denying valid claims. Local property and casualty insurance companies hold most of their assets in banks,

insurance companies into Taiwan, and soon thereafter admitted three property and casualty companies. When further progress toward opening the domestic market to foreign competition stalled, the United States pressured Taiwan with the threat of trade sanctions. In 1989, Taiwan gave additional U.S. companies access to the insurance market, bringing the total to three life and five property and casualty insurers.⁴³

Securities markets in Taiwan, just like other segments of the financial system, have regulated and unregulated sectors. The Securities and Exchange Commission (SEC), under the supervision of the MOF, regulates the Taiwan Stock Exchange (TSE). An informal market exists for margin credit, and occasionally informal markets arise for particular products such as futures contracts,⁴⁴ "under-the-counter" securities,⁴⁵ or options to buy shares in companies with applications pending for new commercial bank licenses.

The securities market of Taiwan dates back to the 1950s when, as part of a land reform program, former landowners were given government securities as compensation for land transferred to tenant farmers. The TSE was founded in 1962 to assist private companies in raising capital. Through 1985, however, the TSE had achieved only limited success in encouraging local companies to raise capital through publicly issued securities. The public perceived the TSE as rife with speculation and insider trading, and principals of closely held companies were unwilling to dilute their control by allowing large blocks of stock to be held by the public. In 1985, only 125 companies were listed on the TSE, and even those companies listed often allowed only a small proportion of outstanding shares to trade on the exchange.⁴⁶

From 1986 to 1990, the TSE enjoyed unprecedented popularity among the investing public as the index of stock values rose from 1,000 to over 12,000. The Securities Exchange Act was revised to liberalize the requirements for granting licenses to brokerages and to permit full service brokerage houses that acted as dealers, brokers, and investment advisors. The number of brokerages increased from 7 to 357 within a few years.⁴⁷ Although the perception remained that trading on the TSE was speculative and insider trading was rampant, this perception now encouraged, rather than discouraged, large-scale public participa-

while local life insurance companies invest heavily in real estate. See Chu, *More American Firms Here Assure Challenge to Locals*, and *The ROC Insurance Industry: 'A 30-Year-Old Infant,'* in FINANCIAL AND INVESTMENT YEARBOOK, ROC 1987, at 134-40 (1987).

43. Shen, *Opening Wider to Foreign Competition*, in FINANCIAL AND INVESTMENT YEARBOOK, ROC 1990, at 94 (1990).

44. See McGregor, *supra* note 28.

45. This is an underground market for private placements of securities, and was quite lively prior to the stock market crash. This contrasts with the official over-the-counter market, which had only two listings. Wang, *Under the Counter Securities Sales in Taiwan*, INT'L FIN. L. REV., Oct. 1990, at 41.

46. Moore, *Nobody Taps Taipei*, FAR E. ECON. REV., Feb. 2, 1989, at 48.

47. Baum, *Brokers' Blues; Shake-out Looms for Taiwan Securities Industry*, FAR E. ECON. REV., Aug. 2, 1990, at 45. There are now more brokerage firms than listed companies in Taiwan.

tion. A large number of people, such as housewives and taxi drivers, became full-time speculators.⁴⁸ Illegal margin lending provided by brokers with access to the informal financial system increased the volume of speculation. The speculative bubble in the TSE burst in early 1990. The market hit an all-time high of 12,495.37 on February 10, 1990, then declined to 2,560.47 on October 1, 1990. By April 5, 1991, the TSE had recovered to 5,344.84.

Although government officials sought to discourage the rampant speculation on the TSE, efforts either to slow down the rise or to break the fall were largely ineffective. The speculative bubble was fueled by excess liquidity in the economy, which found its way to the TSE at least in part through informal margin lending and underground investment houses. Until recently, only the KMT-controlled Fu-Hwa Securities Finance Company was officially allowed to make margin loans against stock as part of a policy to limit the quantity of, and regulate the terms of, margin lending. This policy was frustrated, however, because one service provided by brokerage firms included introductions to sources of informal margin lending.⁴⁹ The ready availability of informal margin credit outside any effective government regulation combined with the stringent standards for regulated margin credit from government-controlled sources is a clear example of the paradoxical attitude toward financial regulation in Taiwan. It also illustrates why the paradox persists. Not only was the Fu-Hwa able to enjoy substantial profits from its monopoly license, but the appearance of strict prudential regulation of margin lending could be maintained while the public enjoyed ready access to informal sources of finance.⁵⁰

The underground investment companies (UICs) rose to prominence in 1986 and 1987, creating major political, economic, and financial problems for ROC authorities and investors. The UICs mushroomed to colossal proportions⁵¹ within only a few years by offering returns to investors of 4 percent or more per month. The initial government response was to do nothing about the UICs, since they were little more than Ponzi or pyramid schemes.⁵² By 1989, it was no

48. Stine, *The Search for Ways to End Financial Anarchy*, ASIAN FIN., July 15, 1990, at 29.

49. One local broker commented on the decision to abolish the monopoly on margin lending by noting that "[i]llegal margin lending was so widespread, anyway, that it's hard to see how we stand to make more profits by going legal and submitting to regulation." Kaye, *Despite the Sobering Experience*, FAR E. ECON. REV., June 28, 1990, at 86.

50. A legal standard that is not widely observed also raises the possible issue of corruption among government officials assigned to enforce the standard. See, e.g., H. DE SOTO, *THE OTHER PATH* 191 (1989).

51. In less than five years, Hung Yuan, the largest UIC, together with some 170 smaller UICs, were estimated to have taken the equivalent of U.S. \$8 billion from more than a million investors in Taiwan. McGregor, *Fate of a Gray-Market Behemoth in Taiwan Could Cause Financial and Political Tremors*, ASIAN WALL ST. J. WEEKLY, Nov. 20, 1989, at 1.

52. The expression in Chinese for a pyramid scheme is *lao shu hui* or "rat club." A Ponzi scheme is "[a] form of fraud in which belief in the success of a fictive enterprise is fostered by payment of quick returns to first investors from money invested by others." 12 OXFORD ENGLISH DICTIONARY 101 (2d ed. 1989).

longer possible to ignore them, but for political reasons neither was it possible to take strong action against them. The most significant group of UICs investors were also traditionally the staunchest supporters of the KMT regime. With an important election in December 1989, government officials did not want to appear responsible for bursting the bubble. Many investors were retired soldiers whose standard of living had eroded as the value of their lump-sum retirement compensation diminished with inflation. By investing the UICs, these investors were able to participate in the surging stock and real estate markets and regain a higher standard of living, although at the considerable risk of losing their principal.⁵³

Official response to UICs came in two stages. In 1989, the government revised the banking law to prohibit UICs from taking additional funds from the public. With no new infusions of funds, the UICs eventually collapsed, but not until after the December 1989 elections. In 1990, the authorities began criminal proceedings against the leaders of some of the most notable UICs.⁵⁴ While the UICs no longer present a threat to the stability of the ROC financial system, it would be erroneous to infer from the demise of the UICs that the informal financial system as a whole has been eliminated.

The informal financial system does not compete with commercial banks so much as complement the services offered by banks and other regulated financial institutions. According to an estimate by one Minister of Finance, 40 percent of the capital requirements of private sector enterprise and 50 percent of the financial needs of families are met through the informal financial system.⁵⁵ An economist recently estimated that from 1976 to 1987 informal sector credit accounted for 30.18 percent to 41.01 percent of the credit required by private businesses.⁵⁶ Recognizable components of the informal financial system include: traditional savings and credit practices such as rotating credit clubs (*hui* or *biao-hui*);⁵⁷ employee deposit taking by companies; underground money lenders (*di xia quan zhang*) and pawn shops; discounting postdated checks (PDCs); informal margin credit for stock purchases; and informal lending and borrowing between otherwise regulated entities.⁵⁸

53. McGregor, *supra* note 51.

54. Mark, *Multibillion-Dollar Pyramid Scam Leads to Taiwan Executives' Arrest*, Wall St. J., Aug. 24, 1990, at A4.

55. Speech by L.T. Hsu, Financial Reform in the R.O.C.—Employing a Financial System Designed to Spur the Development of Science and Technology, at USA-ROC/ROC-USA Economic Councils meeting in Phoenix, Ariz. (Nov. 27, 1993).

56. Friedland, *supra* note 36, at 53 (table of credit sources for private businesses compiled by C.T. Hsu).

57. Loan clubs or rotating credit associations, known as *hui* in Chinese and Vietnamese, are also used by Korean (*kye*), Japanese (*tanomoshi*), Mexican (*tanda*), and West Indian (*susu*) immigrants in the U.S. to raise money outside regulated banking sources. Gorman, *Do-It-Yourself Financing*, TIME, July 25, 1988, at 62.

58. Kaye, *supra* note 7, at 51.

Based on a large scale survey, the ROC Ministry of Justice estimated in 1985 that 85 percent of the population had participated in rotating credit clubs, or *huis*, and 91 percent thought *huis* were a popular form of finance.⁵⁹ *Huis* are usually established on the basis of mutual trust of members or the reputation of the founder of the club rather than on legal documentation.⁶⁰ *Huis* involve a group of people pooling their savings by meeting at regular intervals when each group member makes a fixed contribution. Each member of the group has a turn at receiving the collected pool until all members have received it and the club terminates or begins anew. The right to receive the collected pool of money may be allocated by competitive bidding so that the member willing to pay the highest interest rate receives the pool earlier than other members.

Employee deposit taking was originally encouraged by ROC authorities when credit conditions in Taiwan were highly restrictive. The MOF gave companies incentives to borrow from employees by granting favorable tax treatment to the interest expense incurred on such borrowing.⁶¹ Although the tax incentive no longer exists, the practice of commercial companies taking savings from the public has proven difficult to stamp out.⁶² From the point of view of the employer, encouraging employees to save through investing in the company gives the employees an incentive to support the company, and also relieves the pressure to seek financing from outside sources.⁶³ Higher interest rates have usually been the incentive offered to lure employees away from the regulated financial system.⁶⁴

Underground money lenders are private individuals or gangsters who lend for very short periods at high interest rates.⁶⁵ The CBC monitors conditions in this

59. ROC MINISTRY OF JUSTICE, TAI WAN DI QU MIN JIAN HE HUI XIAN KUANG ZHI YEN JIU [RESEARCH ON THE CURRENT CONDITION OF ROTATING CREDIT CLUBS IN TAIWAN] 25, 129 (1985) (in Chinese).

60. *Id.* at 41.

61. Interview with Professor J. D. Shea, Academia Sinica (June 16, 1990).

62. The 1989 revision of the Banking Law tightened up the prohibition on deposit taking by nonbanks. See *infra* text section III.C.

63. Although the structure of the arrangements are very different, in this regard employee deposit taking in Taiwan serves a similar purpose to employee stock ownership plans or granting stock options to management in the United States.

64. Although the 1989 revision of the ROC Banking Law, discussed *infra* at text section III.C., attempts to prohibit deposit taking by nonbanks, the Central Bank of China Economic Research Department still publishes a figure for the average interest rates on "deposits with firms." For example, for April 1990, the average interest rate for deposits with firms in Taipei City was 1.51 percent a month, with a high of 2.30 percent and a low of 0.90 percent. This compares with a 9.25 percent annual interest rate on a one-year time deposit with the Bank of Taiwan. ECON. RESEARCH DEP'T, CBC, FINANCIAL STATISTICS MONTHLY, TAIWAN DISTRICT, THE REPUBLIC OF CHINA, MAY 1990, at 110, 119 [hereinafter CBC Monthly Financial Statistics May 1990].

65. Many of these money lenders used to provide foreign exchange services when a rigid system of foreign exchange control was in place. Goldstein, *In Exchange for What?*, FAR E. ECON. REV., Oct. 3, 1985, at 67. See also C.J. SHEU, TAI BEI SHI BANG PAI FAN ZUI TUAN TI ZHI SHI ZHENG YEN JUI [RESEARCH ON ORGANIZED CRIME IN TAIPEI] 32 (1990) (in Chinese).

part of the informal financial system and publishes an estimate of the prevailing interest rate together with the rest of the financial statistics for Taiwan.⁶⁶

Many businesses raise capital from other businesses rather than through banks or the stock market. By borrowing from suppliers or customers, businesses can cement existing relationships by offering above-market interest rates.⁶⁷ The problem this and other forms of informal finance raises for regulated lenders such as banks is that these investments are often not reflected in company records.⁶⁸ This failure to record accurately large amounts of informal credit is a function both of the depth of the informal financial market and the low accounting standards applied in the preparation of financial statements.⁶⁹

Local businesses historically have not implemented sophisticated bookkeeping systems for a variety of reasons, including tax evasion.⁷⁰ The Income Tax Law indirectly sanctions the practice of not maintaining adequate accounting records by providing that the tax collecting authority may use industry standards for profitability to estimate the income of a business that cannot produce evidence to prove its actual income.⁷¹ In practice, permitting tax authorities to estimate the profitability of a firm will often produce an effective tax rate lower than that based on actual revenues.⁷² The reluctance of local businesses to establish and maintain reliable financial records has diminished, however, since the benefits of being a publicly listed company became apparent during the stock market boom of 1987–89.⁷³

66. For April 1990 in Taipei, average monthly interest rates for the following types of loans were as follows: (a) loans against PDC—1.88 percent; (b) unsecured loans—1.96 percent; and (c) deposits with firms—1.51 percent. This compares with 9.25 percent a year for one-year deposits with the Bank of Taiwan. CBC Monthly Financial Statistics May 1990, *supra* note 64, at 110, 119.

67. Friedland & Kaye, *Pennies from Heaven: Kerb Financiers Promote Cult of Money*, FAR E. ECON. REV., Jan. 25, 1990, at 54.

68. Goldstein, *A Series of Shocks Rocks an Archaic System*, FAR E. ECON. REV., Apr. 25, 1985, at 74.

69. S. Champion, American Bankers' Comments on Accounting and Auditing Standards in Taiwan (undated); R.S.C. Chen, An Evaluation of Some Aspects of the Public Accounting Profession in Taiwan (1973) (unpublished Ph.D. thesis, University of Mo.-Columbia). See also *infra* text section IV.B.

70. Winn, *Creditors' Rights in Taiwan: A Comparison of Corporate Reorganization Law in the United States and the Republic of China*, 13 N.C.J. INT'L L. & COM. REG. 409, 420 (1988).

71. Income Tax Law art. 83(1) (as amended through Dec. 30, 1987) provides [translation by Lee & Li, Attorneys at Law]:

A taxpayer shall, during the conduct of an investigation or reinvestigation by the collection authority, produce account books and related documents of evidence that will prove the amount of his income. Where such account books and documents of evidence are not produced, the collection authority may determine the amount of his income on the basis of available taxation data or the profit standard of the trade concerned.

In 1986, the MOF published average profitability figures for nine major categories and approximately 750 subcategories of trade and industry.

72. Winn, *supra* note 70.

73. Li, *Accounting: A Growth Profession in Search of More Talent, Better Oversight*, in FINANCIAL AND INVESTMENT YEARBOOK, ROC 1990, at 138 (1990); interview with John G. Sim, partner, KPMG Peat, Marwick, Taipei (July 5, 1990). According to Mr. Sim, the standard that the SEC is understood to apply in reviewing an application of an existing company to list on the TSE is three years of financial statements audited by one of the large, usually internationally-affiliated, CPA firms.

The magnitude of unreported informal borrowing by companies, and the threat to the stability of the financial system posed by such illicit borrowing, became apparent following the Cathay Scandal in 1985.⁷⁴ The Cathay Scandal erupted in February 1985 when the Cathay Plastics Company and the Tenth Credit Cooperative both collapsed after receiving huge sums from investors. Cathay Plastics was controlled by Tsai Chen-chou, a prominent member of the Legislative Yuan or parliament.⁷⁵ Cathay Plastics had absorbed 5 billion New Taiwan dollars (NT\$)⁷⁶ from the public in exchange for PDCs. Cathay Plastics had also improperly borrowed NT\$7.7 billion from Tenth Credit by using the names of employees and then diverting the money to corporate uses, a violation of the requirement that credit cooperatives only lend to individuals.⁷⁷ Foreign bank creditors faced a problem of similar magnitude in the court-ordered reorganization of the Ta Nun Company when private investors were allowed to present huge claims that were not reflected in the company accounts.⁷⁸

C. REGULATION OF BANKS

1. Domestic Commercial Banks

In theory, commercial banks in Taiwan have the power to play a significant role in shaping economic development. In reality, due to substantial direct government interference with management decisions, commercial banks have been allowed to exercise little autonomy, although there are many signs that this finally may be changing. The ROC banking system historically has been seen as an instrument for promoting economic and political policies; as a result, implementation of these government policies had the indirect effect of repressing the

This creates an incentive for companies considering listing to adopt standard accounting procedures and submit to regular audits, but would have no effect on small and medium businesses that are not considering listing on the TSE.

74. Winn, *supra* note 70, at 420, 463.

75. Following the Cathay Scandal, Tsai was convicted of bouncing 5,565 checks for the equivalent of U.S. \$47 million. Shao, *Taiwan Notes*, Asian Wall St. J., Feb. 3, 1986, at 1.

76. In 1985, when the Cathay Scandal occurred, the exchange rate between the NT\$ and the U.S. \$ was 40:1. The exchange rate in April 1990 when this article was written was approximately 27.5:1.

77. Goldstein, *Discredited Policies*, FAR E. ECON. REV., Apr. 11, 1985, at 70. In early February, the Cooperative Bank of Taiwan (Co-op Bank), which is charged with overseeing credit cooperatives, stepped in with an emergency loan of NT\$3 billion to bail out Tenth Credit. This proved inadequate, and in mid-February, the Co-op Bank extended another NT\$6 billion credit to Tenth Credit. China Economic News, Feb. 18, 1985, at 1. An informed local observer speculated off the record in an interview in 1986 that the first tranche of the bailout appeared to have been used to pay off well-placed investors in Tsai's business empire, leaving small investors to take their losses. If true, this information gives further confirmation that large amounts of credit are not reported officially, and also indicates why they might not be reported. This speculation is confirmed by Goldstein, "Most of the [Co-op Bank bailout] money has disappeared, leaving only unsubstantiated, yet widespread rumours that high government and party leaders were paid off by Tsai." *The Never-Ending Story*, FAR E. ECON. REV., Sept. 12, 1985, at 94.

78. Winn, *supra* note 70.

development of the financial system.⁷⁹ The operation of financial markets has been distorted by interest rate controls, the regulation of lending practices, and credit allocation policies.⁸⁰ The licensing of new, privately-owned commercial banks in April 1991 should overcome the problem of credit allocation according to politically established priorities. Personnel of government-owned commercial banks cannot expect to exercise independent judgment in lending and management decisions, however, until those banks are privatized.⁸¹

The ROC Banking Law, promulgated on March 28, 1931, and as amended through July 17, 1989 (Banking Law), is the primary source of law applied to regulated commercial banks in Taiwan. The Banking Law governs the formalities of incorporation, application for licensing, modification or dissolution of a bank's corporate structure, the standards of conduct for bank officers, and regulatory responses to bank failures. Until the most recent amendments, it also regulated the terms on which credit could be provided by banks.

With the 1989 revision of the Banking Law, ROC authorities have finally officially relinquished control over interest rates.⁸² Preferential interest rates as high as 7 percent a month were used with success in the 1950s to curb inflation, but established a precedent of government control over bank interest rates. The deregulation of interest rates was a gradual process, beginning in the 1970s with the establishment of a money market to indicate market-clearing interest rates. In November 1980, the CBC issued regulations authorizing banks to set selected interest rates while expanding the range between maximum and minimum regulated interest rates. In 1985, banks were required to announce a prime lending rate between the maximum and minimum rates set by the CBC, and were authorized to set their own foreign currency deposit rates. In 1989, the authority of the CBC to set interest rates was deleted from article 41 of the Banking Law and maximum and minimum rates were abolished. It now remains to be seen whether abolition of all formal interest rate controls will be enough to allow market forces to determine interest rates in Taiwan.

Earlier versions of the Banking Law contained substantial restrictions on the type of loans a bank could extend. Although these restrictions have been relaxed with each revision and are now no longer included in the Banking Law, they have continued to influence the lending policies of regulated banks for many years after their abolition, contributing to the "pawnshop" approach of these banks.⁸³ For example, until the 1968 revision a bank could not extend unsecured credit for a term greater than six months or credit secured by pledge or mortgage of real

79. OECD, *supra* note 23.

80. *Id.*

81. Baum, *Banking on Big Business*, FAR E. ECON. REV., Apr. 4, 1991, at 36.

82. Shea, *supra* note 32, at 48, 56.

83. Ralph, *Impediments to Modern Banking in Taiwan*, INDUS. OF FREE CHINA, Sept. 1970, at 14.

estate for a term greater than one year.⁸⁴ In 1968, the limitation on unsecured and secured credit was relaxed to permit terms of one and three years, respectively. Additionally, a five-year term was permitted for loans for which the borrower paid off the principal in installments over the term of the loan.⁸⁵ In 1975, this requirement was replaced with the condition that the volume of medium-term credit not exceed the amount of time deposits a bank holds; this condition remains in effect.⁸⁶ Until 1975, regulated banks could extend credit for no more than 70 percent of the appraised value of the collateral.⁸⁷

Responding to these statutory requirements, local bankers focused primarily on collateral rather than on any financial measure of profitability. Bankers structured loans to appear short-term, but both lender and borrower understood that the loans would be rolled over as long as the collateral was in place. This form of credit was known as "evergreen" financing because it focused on the continued existence of the collateral rather than the conduct of the business. As long as the collateral remained in existence, the credit was available. The focus on short-term, secured lending gave rise to the "pawnshop" mentality charge leveled at lending officers in government-owned banks. Due to the lack of reliable financial statements from borrowers, however, bankers resisted any movement toward financial analyses of creditworthiness.⁸⁸

Bankers at government-owned banks have also been constrained not only by regulations concerning the terms of credit but by credit allocation priorities set by the form of "indicative" or noncompulsory economic planning practiced by the ROC government. First, the ROC has given priority for scarce credit to government-owned enterprises; private enterprises that cooperated with government economic plans received the next priority.⁸⁹ By the time applications from po-

84. Banking Law art. 54 (as amended through June 16, 1950).

85. *Id.* art. 54 (as amended through Nov. 11, 1968).

86. *Id.* art. 72.

87. *Id.* art. 37 (as amended through Nov. 11, 1968). In the 1975 revisions, the requirement was only that the bank obtain an appraisal and that the CBC had the authority to regulate the terms of secured credit. *Id.* (as amended through July 4, 1975).

88. U.S. and other foreign bankers entered Taiwan in large numbers in the late 1970s and early 1980s. Finding that most large corporate borrowers already had well-established relationships with local banks, foreign banks rushed into the "middle market" of small and medium-sized businesses. In the recession that began in 1982, foreign bankers learned that the financial statements upon which they had relied in extending the credit were too often largely fictional.

The failure of local lending officers to look beyond collateral in making credit decisions gave rise to an opportunity of sorts for local businesses. If a business could raise start-up money in the informal financial system and acquire title to tangible assets, then those assets might be mortgaged to banks at low rates of interest. The loan proceeds from the regulated lenders could be used to repay loans from the informal sector and cash out the principal's interest in the business, assuming the appraised value of the asset was high enough. This effectively left the regulated lender as the equity interest in the business, but in exchange for a fixed, below-market interest rate and without any compensation for the risk associated with equity investments.

89. T. GOLD, *supra* note 2, at 108-09.

tential borrowers with no connection to government plans were considered, these applications generally exceeded the amount of credit available.⁹⁰

The most severe restrictions on the development of government-owned commercial banks has come from the Control Yuan. The Control Yuan, one of five branches of the ROC government, performs an audit function similar to that of the General Accounting Office of the United States Congress, combined with the power of enforcement. The audit function can be exercised at the request of private citizens or on the Control Yuan's own initiative.⁹¹ As part of this investigative function the Control Yuan has the power to impeach or censure public officials.⁹² The Control Yuan's jurisdiction over commercial banks is based on the government ownership of these banks. This renders commercial bank assets a form of government property and turns employees of government-owned banks into civil service employees. While the banking regulations of the CBC and MOF are largely based on modern financial concepts, Control Yuan banking regulations appear archaic and draconian by comparison. For example, according to conventional notions of corporate finance, a shareholder owns an undivided partial interest in the corporation as a whole but does not own any individual asset of the corporation. Title to a particular asset (such as a loan in the case of a financial institution) is held instead by the corporation, a distinct legal entity. The Control Yuan, by contrast, believes that not just the government-held shares but each loan made by a government-owned bank is public property. Every default on a loan from a government-owned bank is a loss of public property that may warrant a Control Yuan investigation and prosecution. While in practice a bank officer responsible for an uncollectible loan may face demotion or reprimand, in theory, responsibility could extend to unlimited personal liability for the amount of the loan and criminal penalties.⁹³

One consequence of the emphasis on collateral in lending and justifiable fear of Control Yuan oversight has been the failure of lending officers at government-owned banks to adopt modern lending practices. Fortunately, the focus on the value of collateral in lending is no longer mandated by statute, and the oversight of the Control Yuan will end with the privatization of the commercial banks. The shortage of bank and regulatory personnel trained in modern lending practices and principles of financial analysis cannot quickly be remedied, however, and will pose a serious obstacle to the rapid liberalization of commercial banking in Taiwan.

90. As one bank manager commented off the record, a bank officer confronted with a large number of applications that all meet official standards is well placed to receive bribes.

91. ROC CONST. art. 90; REPUBLIC OF CHINA 1986: A REFERENCE BOOK 140 (D.D.S. Sung & L.C. Ho eds. 1986) (referring to provisions of the Control Law). Members of the Control Yuan are elected. ROC CONST. art. 91.

92. ROC CONST. art. 97.

93. Liang, *Financial Reforms Recommended by the Economic Reform Committee, Republic of China*, INDUSTRY OF FREE CHINA, Mar. 1986, at 9.

Whether ROC officials succeed in liberalizing Taiwan's banking system will depend on whether the authorities are able to monitor and regulate bank activities effectively. The largely unsuccessful experiment with trust companies offers insight into what might go wrong if the newly licensed and privately owned commercial banks are not adequately supervised.⁹⁴ Inadequate official supervision combined with unsound management practices at many trust companies led first to a rapid expansion in the late 1970s and early 1980s followed by several spectacular failures. Instead of developing the market for long-term investments (as regulators had hoped), trust companies in the late 1970s and early 1980s expanded rapidly by competing with commercial banks. Several trust companies ran into severe problems in the mid-1980s as local real estate and stock markets collapsed, drying up speculative profits. Some trust companies, such as Asia Trust and Cathay Trust, overextended credits to affiliated companies. Among the seven trust companies licensed in the early 1970s, three have experienced major liquidity crises and have been rescued through official intervention.⁹⁵

2. Foreign Commercial Bank Branches Operating in Taiwan

Foreign banks have done business in Taiwan for over thirty years, and yet the position of foreign banks remains marginal in many respects. Internationalization of the ROC financial system will only be achieved if foreign banks are allowed greater access to local markets and are authorized to engage in a broader spectrum of activities. Despite official proclamations that the ROC banking system is internationalizing, changes in the status of foreign banks have come slowly.⁹⁶

Foreign banks have operated in Taiwan since Dai-Ichi Kangyo Bank of Japan opened a branch in 1959. Until the late 1970s, however, official policy placed strict limitations on foreign bank presence in the country. During the 1970s, conditions changed in both Taiwan and the international banking community, and a dramatic influx of foreign banks into Taiwan began. In 1971, the People's Republic of China (PRC) took the ROC's place at the United Nations, and in 1979 the United States shifted its diplomatic recognition away from the ROC in favor of the PRC. These diplomatic developments seem to have contributed to a

94. K. Field, *supra* note 17, at 169.

95. In 1982, Asia Trust encountered serious liquidity problems and management was turned over to the International Commercial Bank of China. Asia Trust was the finance arm of the Asiaworld group of companies. In 1985, the Cathay Trust experienced a run and was taken over by a group of banks in an informal rescue. Later in 1985, the Overseas Trust was taken over by the United World Chinese Commercial Bank after a run on deposits sparked in part by the collapse of Cathay Trust. Overseas Trust officials were later found to have misappropriated funds and were prosecuted. Huang, *Taiwan's Trust & Investment Companies: Can They Survive?*, in FINANCIAL AND INVESTMENT YEARBOOK, ROC 1986, at 102 (1986).

96. *ROC Commits Itself to Financial Internationalization*, Cent. News Agency, Jan. 16, 1991; Owens, *Officials' Dreams of Creating Financial Center Slowed by Regulatory Barriers*, *Taipei Stigma*, Asian Wall St. J. Weekly, July 15, 1991, at 10.

reconsideration of the KMT regime's on foreign bank presence just when international banks were flush with recycled petrodollars following the second major OPEC oil price increase. Taiwan had also experienced almost two decades of continuous rapid economic growth, and by admitting foreign banks to perform a limited range of services, ROC officials hoped to upgrade the quality of banking services offered while still sheltering domestic banks from the full force of foreign competition. In June 1979, thirteen foreign banks had branches in Taipei.⁹⁷ As of September 1990, a total of fifty-five foreign banks were doing business in Taiwan either through branch or representative offices.⁹⁸

Although the number of foreign banks operating in Taiwan has increased dramatically over the last decade, their significance to the financial system as a whole has not increased commensurately. According to one economist's estimate, the presence of foreign banks measured by the number of offices they maintain as a percentage of all offices maintained by banks or similar financial institutions is only about 1 percent.⁹⁹ Further, estimated assets held by foreign banks as a percentage of all financial assets, including the postal savings system and insurance companies, measured just under 3 percent in 1989.¹⁰⁰ According to MOF estimates, foreign banks control 1 percent of NT\$ deposits and less than 5 percent of the domestic loan market.¹⁰¹

The ROC authorities have only recently begun to relax the severe constraints on foreign bank operations in Taiwan. In 1986, according to the Office of the U.S. Trade Representative, foreign banks suffered the following disadvantages in Taiwan: a prohibition on equity investments in local banks; a prohibition on the establishment of wholly owned subsidiaries (although limited investments in leasing companies and trust and investment companies were allowed); and severe restrictions on branching and the scope of business activities.¹⁰²

In 1986, foreign banks could establish only two branches: one in Taipei and one in Kaohsiung. A minimum working capital of U.S. \$2 million was required to set up a branch, and the volume of loans was limited to 12.5 times the amount

97. I.S. Sun, Possible Future Developments Affecting Foreign Banks Dealing with Taiwan 1 (June 5, 1979) (paper presented at ROC/US—US/ROC Joint Economic Council Meeting).

98. Mark & Owens, *supra* note 22, at 1.

99. In 1961, foreign banks represented 0.07 percent of all units; in 1970, 0.38 percent; in 1980, 0.74 percent; and in 1989, 0.99 percent. Shea, *supra* note 32, table 1.

100. In 1961, it was 0.88 percent; in 1970, 2.95 percent; in 1980, 5.49 percent; and in 1989, 2.98 percent. *Id.* The increase in 1980 and the subsequent decline no doubt reflects the trend of foreign banks to move toward fee generating activities and away from lending after many foreign banks sustained heavy losses on lending in the early and mid-1980s.

101. Mark & Owens, *supra* note 22.

102. OFFICE OF THE U.S. TRADE REPRESENTATIVE, NATIONAL TRADE ESTIMATE: 1986 REPORT ON FOREIGN TRADE BARRIERS 247–48 (1986); [hereinafter USTR 1986 REPORT]. The report also lists the following further disadvantages: high minimum capital requirements and restrictive screening criteria for admission; restricted access to CBC rediscount facilities; a prohibition on offshore foreign exchange settlements; and exclusion from the Foreign Exchange Center, which helps set exchange rates.

of paid-in capital.¹⁰³ Because the Banking Law provided that a foreign bank branch in Taiwan should be considered a type of commercial bank, foreign banks could not accept long-term deposits, that privilege being reserved to savings banks.¹⁰⁴ Other regulations provided that foreign banks could not take deposits with a term of more than six months, but had to rely on short-term funding sources.¹⁰⁵ Foreign banks were also prohibited from providing financial services to individuals.¹⁰⁶ Further, foreign banks had only limited access to rediscount facilities at the CBC¹⁰⁷ and were denied access to redeposited funds from the Postal Savings System.¹⁰⁸ In addition, foreign banks were subject to limitations on local currency lending, commercial paper guarantees, and construction project lending.¹⁰⁹ Foreign banks were also restricted in their participation in foreign exchange markets.¹¹⁰

II. Pressures for, and Resistance to, Internationalization

A. U.S. POLICIES AIMED AT REDUCING THE ROC'S TRADE SURPLUS WITH THE UNITED STATES

Taiwan's economic miracle is due not only to the hard work of the people of Taiwan and the economic policies of the ROC government, but also to the concerted support and encouragement the United States has given the ROC since 1950.¹¹¹ By the 1980s, Taiwan had been transformed from a rural outpost of the Chinese and Japanese empires to an exporting powerhouse, due in part to substantial assistance from the United States in the form of concessionary customs duties on Taiwan's exports.¹¹² Within the last decade, U.S. policy toward Tai-

103. Criteria for the Establishment of a Foreign Bank Branch or Representative Office, 1983 Foreign Bank Criteria art. 13 (promulgated by the MOF on August 23, 1983) [hereinafter 1983 Foreign Bank Criteria].

104. Banking Law art. 121 and art. 71 (as amended through May 20, 1985).

105. 1983 Foreign Bank Criteria, *supra* note 103, art. 11.

106. *Id.* art. 14.

107. USTR 1986 REPORT, *supra* note 102, at 247.

108. The Postal Savings System was established in 1930 and offers savings and payment services to the public through offices of the Post Office. The savings it receives from the public are redeposited with banks, and historically have been directed to banks whose lending was premised on the fulfillment of specific economic policies. Such banks include the Bank of Communications, the Farmers Bank of China, the Land Bank of Taiwan, and the Medium and Small Business Banks. CENT. BANK OF CHINA, *supra* note 36, at 8.

109. Kaplan, *supra* note 8, at 10.

110. *Id.* at 14.

111. Cumings, *The Origins and Development of the Northeast Asian Political Economy: Industrial Sectors, Product Cycles and Consequences*, in THE POLITICAL ECONOMY OF THE NEW ASIAN INDUSTRIALISM 65 (F.C. Deyo ed. 1987).

112. Despite its outstanding economic performance, Taiwan continued to enjoy the benefits of the U.S. Generalized System of Preferences (GSP) (*see* 19 U.S.C. §§ 2462-2466 (1988)) program designed to facilitate exports from developing countries to the U.S. market. In 1986, Taiwan was the largest single recipient of GSP benefits. Not until January 2, 1989, did the U.S. exclude Taiwan from the system. MESSAGE FROM THE PRESIDENT OF THE UNITED STATES TRANSMITTING NOTIFICATION OF HIS

wan has gradually undergone a substantial transformation as Taiwan first graduated from the status of a mere developing country to that of a "newly industrialized country," and then moved on to achieve virtually the largest foreign exchange reserves in the world, accompanied by a massive, continuing trade surplus with the United States.¹¹³

There have been several official U.S. responses to Taiwan's growing economic strength and the continuing trade imbalance between the two countries: termination of Taiwan's eligibility for benefits under the Generalized System of Preferences program;¹¹⁴ threats of retaliatory trade sanctions for foreign countries that fail to grant reciprocal treatment in trade matters; requests for national treatment for U.S. entities operating in Taiwan; and criticism of exchange rate manipulations that artificially preserve the Taiwan balance of payments surplus. With regard to opening markets in Taiwan to U.S. financial services, the policies have met with significant, but not unqualified, success.

1. *Trade Act and Reciprocity*

In response to the perception that U.S. exporters were denied equal access to the domestic markets of countries exporting to the United States, Congress passed section 301 of the Trade Act of 1974.¹¹⁵ The statutory provisions governing section 301 trade sanctions were amended and strengthened in 1979, 1984, and 1988.¹¹⁶ Section 301 grants the President authority to promote equal access for U.S. exporters by taking appropriate action to eliminate unreasonable trade practices by foreign nations exporting to the United States.¹¹⁷ If the President, acting through the U.S. Trade Representative (USTR), determines that a trade restriction of a foreign country is "unjustifiable, unreasonable, or discriminatory and burdens or restricts U.S. commerce,"¹¹⁸ then the USTR may suspend or prevent the application of, or may refrain from proclaiming, benefits of trade agreement concessions, or may impose duties or other import restrictions

INTENT TO REMOVE . . . TAIWAN . . . FROM THE LIST OF BENEFICIARY DEVELOPING COUNTRIES UNDER THE GSP, H.R. DOC. NO. 162, 100th Cong. 2d Sess. (1988).

113. In January 1991, Taiwan's foreign exchange reserves were U.S. \$73 billion. Holloway, *Taiwan Too Reserved*, FAR E. ECON. REV., Jan. 31, 1991, at 48. In 1990, per capita income in Taiwan was equal to U.S. \$7,990, which ranked Taiwan 25th in the world in terms of per capita income levels. Baum, *Rich in Six Years*, FAR E. ECON. REV., Feb. 14, 1991, at 48.

114. See *supra* note 112.

115. Trade Act of 1974, Pub. L. No. 93-618, sec. 301, 88 Stat. 1978, 2041-43 (codified as amended at 19 U.S.C. § 2411 (1988)).

116. Trade Agreements Act of 1979, Pub. L. No. 96-39, sec. 301, 93 Stat. 144, 236 (codified as amended at 19 U.S.C. § 2511 (1988)); Trade and Tariff Act of 1984, Pub. L. No. 98-573, sec. 304, 98 Stat. 3002-06 (codified at 19 U.S.C. §§ 2411-2416 (1988)); and Omnibus Trade and Competitiveness Act of 1988, sec. 1301, 102 Stat. 1164 (codified at 19 U.S.C. § 2411 (1988)).

117. Trade Act of 1974, Pub. L. No. 93-618, sec. 301(a), 88 Stat. 1978, 2041-43 (codified as amended at 19 U.S.C. § 2411(a)(1988)).

118. *Id.* sec. 301(a)(2)(B), 88 Stat. 1978, 2041-43 (codified as amended at 19 U.S.C. § 2411(a)(2)(B) (1988)).

on goods.¹¹⁹ The 1988 amendments created "Super 301" sanctions: the USTR can identify "priority" countries that have established "systemic" barriers to U.S. exports, and can authorize retaliatory action in response to "priority" foreign trade problems.¹²⁰

Since statutory provisions governing section 301 trade sanctions were strengthened in 1984,¹²¹ Taiwan has been the subject of repeated investigations by the USTR and has participated in many negotiations to avoid the imposition of trade sanctions.¹²² In 1986, Taiwan was investigated for its customs valuation system,¹²³ its state alcohol and tobacco monopoly distribution system,¹²⁴ and export performance requirements.¹²⁵ Although not among the three countries named for consideration under Super 301 provisions in 1989, Taiwan was among the nations considered for such treatment.¹²⁶

The opening of the insurance industry of Taiwan to greater participation by U.S. companies has been an issue considered by the USTR. In 1990, the USTR found that Taiwan still had significant barriers to entry into its insurance markets.¹²⁷ ROC authorities have allowed a maximum of two life and two nonlife U.S. insurance companies to establish operations in Taiwan each year, and companies already in Taiwan face restrictions regarding investment in real estate and branching. The ROC does not permit U.S. mutual insurance companies to do business in Taiwan because they are not authorized under the ROC Insurance Law. For some time the ROC authorities have been considering amending the Insurance Law to permit mutual companies to enter Taiwan, but have not yet acted in this regard.¹²⁸

119. *Id.* sec. 301(b)(1)-(2) (codified at 19 U.S.C. § 2411(b)(1)-(2) (1988)). Private parties can also petition to initiate an investigation, and until 1985, all investigations were undertaken at the instigation of private parties. 19 U.S.C. §§ 2411(c)(1)-(2), 2412. See Note, *Defining Unreasonableness in Section 301 of the 1974 Trade Act*, 96 YALE L.J. 1122 n.11.

120. Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, title I, sec. 1302(a), 102 Stat. 1176 (codified as amended at 19 U.S.C. § 2420 (1988)).

121. Prior to 1984, Taiwan was the subject of numerous complaints for unfair trade practices. These included complaints about tariffs on major appliances (1979); nonrubber footwear (1982); rice export subsidies (1983); and films (1983). *Oversight of the Trade Act of 1988: Hearing Before the Senate Comm. on Finance*, 101st Cong., 1st Sess. 69 (1989) [hereinafter *Trade Act Hearing*].

122. *Taiwan Plans Appeal Against U.S. Trade Blacklist*, Reuters Apr. 18, 1990; see also Kaye, *Taipei Says "No,"* FAR E. ECON. REV., Apr. 19, 1990, at 82.

123. *Trade Act Hearing*, *supra* note 121, at 63.

124. *Id.* at 64.

125. *Id.* at 69.

126. Moore, *Pressure Point*, FAR E. ECON. REV., Mar. 2, 1989, at 92.

127. U.S. TRADE REPRESENTATIVE, 1990 NATIONAL TRADE ESTIMATE REPORT ON FOREIGN TRADE BARRIERS 189-90 (1990) [hereinafter USTR 1990 REPORT].

128. The Executive Yuan (cabinet) passed a draft revision of the Insurance Law and sent it to the Legislative Yuan (legislature) on April 26, 1990. In addition, in trade negotiations with the United States in May 1990, ROC authorities agreed to loosen somewhat the regulatory standards for admission of U.S. insurance companies to Taiwan, and raised the quota for the number of companies that could be admitted each year. The issue of mutual companies had not yet been resolved, however. Huang and Chen, *Draft Revision of the ROC Insurance Law Passed*, 2 ASIA L. & PRAC. 27 (1990).

2. *International Banking Act and National Treatment*

Although discrimination against U.S. banks operating in Taiwan has periodically been considered in conjunction with other trade barrier issues, the demand of U.S. banks for equal access to the domestic markets of foreign banks operating in the United States is often dealt with separately.¹²⁹ The standard of "national treatment" for U.S. banks overseas was adopted with the enactment of the International Banking Act of 1978, as amended (IBA).¹³⁰ The national treatment standard applied to U.S. bank operations overseas is aimed at securing equality of competitive opportunity between foreign and domestic institutions in similar circumstances, rather than the precise balancing of specific regulations implied in a reciprocity standard.¹³¹ The concept of "national treatment" does not, however, include a threat of retaliation like that found in the section 301 and Super 301 provisions of the Trade Act.¹³² The IBA and the Financial Reports Act of 1988¹³³ require instead that the Secretary of the Treasury periodically report on the treatment of U.S. banks in foreign markets, and that the President or his designee conduct discussions with the governments of countries that are major financial centers. The Reagan and Bush Administrations have resisted the use of a reciprocity standard in international financial markets because even limited reciprocity has been seen as bringing a risk of retaliation. The impact of possible retaliation "could be devastating to confidence in world financial markets and established patterns of monetary and capital flows."¹³⁴

This bifurcated procedure for seeking to eliminate barriers to most U.S. exports under legislation aimed at reciprocity, combined with a threat of retaliation on the one hand and seeking to eliminate barriers to U.S. financial services under a national treatment standard on the other, seems to place U.S. efforts to encourage the ROC to open its domestic banking market on the level of moral suasion.¹³⁵ There have been repeated unsuccessful attempts in Congress in recent

129. See, e.g., USTR 1990 REPORT, *supra* note 127, at 209, where financial market issues are in an appendix at the end of the report and the coverage is based on information filed by interested parties, not on the research of the U.S. Trade Representative. Equal competitive access for U.S. banks overseas were dealt with instead in U.S. DEP'T OF THE TREASURY, 1990 NATIONAL TREATMENT STUDY—REPORT ON FOREIGN TREATMENT OF U.S. FINANCIAL INSTITUTIONS (1990) [hereinafter 1990 NATIONAL TREATMENT STUDY].

130. 12 U.S.C. §§ 3101–3108 (1988). The requirement that the Secretary of the Treasury study discrimination against U.S. banks in foreign markets is codified in a note to 12 U.S.C. § 601 (1988). Pub. L. No. 95-369, sec. 9(a), 92 Stat. 623 (1978).

131. U.S. DEP'T OF TREASURY, 1986 NATIONAL TREATMENT STUDY 1, 17.

132. *Id.*; see also Orr, *Reciprocity and Regulation of Entry*, 1988 U. ILL. L. REV. 333, 334.

133. Financial Reports Act of 1988, §§ 3602–3603, Pub. L. No. 100-418, 102 Stat. 1387 (codified at 22 U.S.C. §§ 5352–5353 (1988)).

134. 1990 NATIONAL TREATMENT STUDY, *supra* note 129, at 202. The European Community threatened to adopt a reciprocity standard when the Single Market legislation goes into effect on January 1, 1993, but after strong U.S. opposition, a national treatment standard was adopted in the Second Banking Directive. *Id.* at 203.

135. While this may seem paradoxical with regard to the position of U.S. banks in Taiwan, the bifurcation clearly favors the United States in the context of negotiations with the European Community, as mentioned *supra* note 134.

years to modify the standards of the IBA to permit more forceful action by the United States in response to Taiwan's failure to grant national treatment to U.S. banks.¹³⁶

3. *Exchange Rate Manipulation*

The United States has focused its attention not only on increasing exports of U.S. services to Taiwan, but also of accelerating the liberalization of ROC foreign exchange regulations. Although Taiwan's continuing trade surplus and immense foreign exchange reserves are due in part to its successful export-oriented economic programs, an undervalued exchange rate has allowed these conditions to persist longer than would otherwise have been possible.¹³⁷ In 1988, as part of the amendments to the Trade Act, Congress mandated that the administration take steps to stop manipulation of foreign exchange rates that contributes to the U.S. trade deficit.¹³⁸ Under the Exchange Rates and International Economic Policy Coordination Act of 1988, the President is authorized to enter into negotiations with other countries found to be manipulating their currencies and having a significant trade surplus with the United States.¹³⁹ The Secretary of the Treasury is also required to publish a report on exchange rate policies of trading partners every six months.¹⁴⁰ Taiwan's foreign exchange rate policy has figured prominently in every report prepared by the Treasury since 1988.¹⁴¹

Prior to 1987, the CBC exercised substantial control over the market for foreign exchange in Taiwan.¹⁴² Under the Statute for Administration of Foreign Exchange (SAFE), private parties were not allowed to hold foreign currencies

136. As this article is being written, the Fair Trade in Financial Services Act of 1990 (FTFSA) is before the Senate. A bill to amend the Defense Production Act of 1950 was introduced on February 5, 1991, title IV of which relates to fair trade in financial services. S. 347, 102d Cong., 1st Sess. (1991). If enacted, the FTFSA would create a framework for negotiations, periodic reports, and discretionary sanctions to encourage U.S. trading partners to grant national treatment to U.S. banks overseas. The FTFSA also gives the Secretary discretion to apply sanctions, but does not give private parties the right to initiate proceedings as is found in the Trade Act. *Id.* § 15(d). For earlier attempts to add a threat of retaliation to the national treatment standard, see Orr, *Reciprocity and Regulation of Entry*, 1988 U. ILL. L. REV. 333, discussing the Breaux Amendment to S. 790, 100th Cong., 1st Sess., 133 CONG. REC. S3934 (1987), and title IV of the initial version of the Omnibus Trade and Competitiveness Act of 1988.

137. U.S. DEP'T OF TREASURY, REPORT TO CONGRESS ON INTERNATIONAL ECONOMIC AND EXCHANGE RATE POLICY, OCT. 1988, at 15 (1988) [hereinafter OCT. 1988 REPORT].

138. Exchange Rates and International Economic Policy Coordination Act of 1988, sec. 3001, (Pub. L. No. 100-418), 102 Stat. 1372, codified at 22 U.S.C. § 5301 (1988)).

139. *Id.* sec. 3004, 102 Stat. 1373 (codified at 22 U.S.C. § 5304 (1988)).

140. *Id.* sec. 3005, 102 Stat. 1374 (codified at 22 U.S.C. § 5305 (1988)).

141. OCT. 1988 REPORT, *supra* note 137, at 16; REPORT TO CONGRESS ON INTERNATIONAL ECONOMIC AND EXCHANGE RATE POLICY, APR. 1989, at 17 (1989) [hereinafter APR. 1989 REPORT]; REPORT TO CONGRESS ON INTERNATIONAL ECONOMIC AND EXCHANGE RATE POLICY, OCT. 1989, at 18 [hereinafter OCT. 1989 REPORT]; REPORT TO CONGRESS ON INTERNATIONAL ECONOMIC AND EXCHANGE RATE POLICY, APR. 1990, at 16 [hereinafter APR. 1990 REPORT]; REPORT TO CONGRESS ON INTERNATIONAL ECONOMIC AND EXCHANGE RATE POLICY, OCT. 1990, at 23 [hereinafter OCT. 1990 REPORT].

142. Liu, *supra* note 5, at 69, 70.

remitted into Taiwan, but were required to exchange them for local currency, and access to foreign currency was strictly supervised to ensure that it was allocated in accordance with government priorities.¹⁴³ In 1987, SAFE was amended and new regulations were issued permitting outward remittances of up to U.S. \$5 million a year and inward remittances of up to U.S. \$2 million, subject to minor qualifications. Remittances of larger amounts still require screening by the authorities.¹⁴⁴ On April 3, 1989, the ROC authorities adopted a new exchange rate system. Transactions above U.S. \$30,000 were to take place at freely determined rates, while smaller transactions were to take place at rates set with reference to the freely floating rates. Although a step forward in principle, the implementation of the new system was seen by U.S. observers as less than desirable. Responsibility for setting foreign exchange rates shifted from direct official control by the CBC to indirect official control by government-owned banks,¹⁴⁵ and under this new system, less information regarding actual transactions would be available.¹⁴⁶

In 1988, the U.S. Treasury Department criticized the ROC for manipulating the value of its currency to gain trading advantages. According to the report, the ROC sought a competitive advantage for exports to the United States by keeping its currency at artificially low levels against the U.S. dollar.¹⁴⁷ Even though ROC authorities permitted the local currency to appreciate 6.5 percent against the U.S. dollar over the next six months, ROC authorities were again criticized for not making enough progress in liberalizing foreign exchange markets, and thus sustaining the massive buildup in ROC foreign exchange reserves.¹⁴⁸ In April 1990, the Treasury found that although no evidence existed of direct exchange rate manipulation, Taiwan's external surplus was so large it raised a question of indirect manipulation and demonstrated the need for further liberalization of ROC exchange rate policies.¹⁴⁹

143. The severity of this foreign exchange control system was of course substantially lessened by the presence of a large informal foreign exchange market. The magnitude of such a market can only be guessed, but anecdotal information indicated that it was substantial. According to one account prior to the repeal of most foreign exchange regulations, a foreign resident walked into an informal money changer's office and without any prior arrangement, purchased U.S. \$50,000 with local currency. Goldstein, *supra* note 65.

144. Liu, *supra* note 5.

145. For example, the NT\$ appreciated sharply following the unfavorable U.S. Treasury report on currency manipulation by ROC authorities in April 1989, but then remained stable after the Treasury informed Congress in May 1989 that no further appreciation was necessary. OCT. 1989 REPORT, *supra* note 141, at 18.

146. APR. 1989 REPORT, *supra* note 141, at 19.

147. OCT. 1988 REPORT, *supra* note 141, at 16; see also Brooks, A "Super 301" Trade Ruling: Too Early for Seoul and Taipei, HERITAGE FOUND. REP., May 25, 1989, Background No. 91.

148. APR. 1989 REPORT, *supra* note 141, at 19. In October 1989, Treasury officials found no clear indications that Taiwan was manipulating its exchange rate, but declared its intention to continue to monitor the situation carefully. OCT. 1989 REPORT, *supra* note 141, at 21.

149. APR. 1990 REPORT, *supra* note 141, at 19.

B. DEMAND WITHIN TAIWAN FOR A MORE COMPETITIVE BANKING INDUSTRY

There are many indicators of public demand in Taiwan for more competitive banking and financial services. These include the experiences of the trust companies, some of which ignored statutory mandates to the contrary and competed with commercial banks. The phenomena of deposit-taking by industrial companies,¹⁵⁰ unofficial margin credit for stock market speculation, and the growth of underground investment companies are some indication of the degree of public dissatisfaction with the level of financial services available. Continued public participation in informal financial markets not only poses a threat to the safety and soundness of the regulated financial system; the predominantly short-term, high-interest financing available through the informal sector may be inadequate to meet the needs of Taiwan's maturing economy. A mismatch may arise between the type of financial services required by more sophisticated trade and industry in Taiwan and the financing options available in the informal financial market.

The official response to demand for more competitive banking services has been twofold: to privatize the government-owned banks, and to license new privately owned commercial banks. These responses are considered in detail in section III below.

C. DEMAND FROM INVESTORS AND BUSINESSES IN TAIWAN FOR GREATER ACCESS TO OVERSEAS FINANCIAL SERVICES

During recent decades of rapid economic growth, investors in Taiwan have accumulated significant financial reserves, and in response to the limited range of investment alternatives in Taiwan, are now making substantial investments outside Taiwan. Families in Taiwan have a very high rate of savings. In 1987, gross domestic savings were estimated at 40.4 percent of the gross national product.¹⁵¹ During the early decades of industrialization, few opportunities for consumption existed because domestic production was aimed at export markets and domestic consumption was kept down behind high tariff and other protective barriers excluding against foreign imports. After severe foreign exchange problems in the 1950s, ROC authorities implemented and maintained a strict regime of foreign exchange controls. These controls prevented ROC citizens from holding foreign currency by requiring that all export earnings be converted to local currency.¹⁵²

150. During a visit to Taipei in 1990, this author learned from several observers that, notwithstanding the clear prohibition on such activities introduced into articles 29 and 29-1 of the Banking Law with the 1989 revisions (discussed *infra* text section III.C), some major companies that have traditionally relied on deposit-taking from employees as a source of funding continue to do so. This activity could not persist without the tacit approval of the authorities.

151. ECONOMIST INTELLIGENCE UNIT, TAIWAN COUNTRY PROFILE, 1989-90, at 30 (1991).

152. During the period of strict exchange controls, one of the primary services of the informal financial system was illicit currency exchange. The amount of assets illicitly accumulated offshore

Although individuals and businesses have been able to accumulate huge financial reserves, until recently access to international investment services in Taiwan and opportunities for direct investment overseas have been severely limited by official exchange rate policies. With the reform of ROC foreign exchange regulations,¹⁵³ ROC citizens are now permitted to make up to U.S. \$5 million in either direct investment or portfolio investment with minimal official supervision.¹⁵⁴

As ROC citizens enjoy greater freedom to travel and invest overseas, local financial institutions have also expanded into overseas markets. In the last year, ROC banks have opened seven new branches in the United States.¹⁵⁵ Three government-owned banks slated for privatization are among those opening branches, along with the Bank of Taiwan. These branches have opened primarily to improve the service ROC banks can offer their domestic customers in overseas markets.¹⁵⁶

III. Policies to Facilitate Internationalization

A. PRIVATIZATION OF GOVERNMENT-OWNED BANKS

A wide-ranging package of reforms was adopted by ROC authorities when the Banking Law underwent substantial revision in 1989. In response to lobbying from local business interests represented in the legislature, ROC authorities finally relaxed their long-standing opposition to competition in banking services. The authorities committed themselves to privatize government-owned commercial banks.¹⁵⁷ Interest rates have been deregulated,¹⁵⁸ new commercial bank licenses have been granted to local investors, and the authorized scope of foreign bank activities has been expanded.¹⁵⁹ The only unresolved issue is the privatization of the government-owned commercial banks.

Shares in the three major commercial banks were owned not only by the central government, which sold off its interest in March 1990, but also by the

was a matter of speculation, but it was clearly substantial. For example, two devices were available to importers and exporters to evade exchange controls. One was falsifying the price stated in customs documents so that either too little foreign currency would be remitted to Taiwan for exports or too much foreign currency would be remitted out for imports, with the balance being paid into a foreign bank account. Another device was the establishment of a Hong Kong trading company that purchased all exports from the Taiwan operation at a slight markup above cost and resold at contract prices, or sold imports to the Taiwan operation at a substantial markup over cost, concentrating profits in Hong Kong where no foreign exchange controls applied. These devices obviously were not available to ordinary citizens who did not run trading companies.

153. See *infra* text section II.A.

154. Liu, *supra* note 5, at 72-74.

155. Kraus, *Banks from Smaller Nations in Asia Opening U.S. Offices*, AM. BANKER, Feb. 12, 1991, at 8.

156. *Id.*

157. Baum, *supra* note 81.

158. See *id.*

159. See *infra* subsection B on new commercial bank licenses and subsection D on foreign banks.

Taiwan provincial government.¹⁶⁰ The Taiwan provincial government, however, remains reluctant to relinquish its control over the banks, which constitute a major source of revenue for local government and patronage for local politicians. As a result, the three provincial banks must now compete with the newly licensed privately owned banks while still hobbled by government interference.

Although in some ways the three provincial banks are well positioned to compete with the newly licensed privately owned commercial banks, in other respects they will have to struggle. The big three enter the competition with more than 100 branches each and well-developed ATM systems.¹⁶¹ The new banks face a significant problem of staffing, which they are trying to solve by poaching qualified personnel from any existing commercial banks, whether government or privately owned.¹⁶² While the big three have established relationships with all the major business entities on the island, the competition to keep those accounts will be stiffer.¹⁶³

B. LICENSING NEW PRIVATELY OWNED COMMERCIAL BANKS

Prior to the new policy initiatives undertaken by ROC authorities at about the same time the 1989 Banking Law reforms were enacted,¹⁶⁴ there was a moratorium on granting new commercial bank licenses.¹⁶⁵ From the 1950s to the current reform, the ROC licensed no major private banks, although several institutions brought over from mainland China were reactivated during the 1950s and 1960s. Although various institutions have been allowed to enter the margins of the banking system in Taiwan, such as the three small, privately owned commercial banks,¹⁶⁶ the trust and investment companies, and the foreign banks, government-owned banks have dominated the system since 1949.

Although KMT hostility to private ownership of banks is often justified with allusions to the Three Principles of the People¹⁶⁷ or to the hyperinflation of the

160. Baum, *supra* note 81.

161. *Id.*

162. *Id.*

163. *Id.*

164. See discussion *supra* note 157.

165. Wang & Yang, *supra* note 5, at 28.

166. These are International Commercial Bank of China, United World Chinese Commercial Bank, and the Shanghai Commercial & Savings Bank, Ltd.

167. The official ideology of the ROC is the "Three Principles of the People" formulated by the founder of the modern Chinese nation, Dr. Sun Yat-sen. The three principles are democracy, nationalism, and "people's livelihood." "People's livelihood" is somewhat similar to socialism in that it requires public ownership of certain essential services such as transportation, communication, and perhaps even banking. Y.S. SUN, THREE PRINCIPLES OF THE PEOPLE 104 (F. Price trans. 1981). See also Wang & Yang, *supra* note 5, at 44. Thus the KMT has an ideological mandate to manage certain economic resources for the public benefit. In the past there was a problem of lack of accountability in the exercise of this mandate because until 1987 no official political opposition to the KMT was allowed.

1940s, government control of banks has important political implications.¹⁶⁸ The policy against private ownership of banks reflected the concern to retain indirect control of economic development in Taiwan, where until recent years, the KMT ran an autocratic state in cooperation with the armed forces and the internal security apparatus. By retaining control of the financial system, however, the KMT had an important tool to support its continued dominance in Taiwan.¹⁶⁹

Pressures for liberalization and internationalization of the financial system are now eroding this close connection between political objectives and financial policies. On July 17, 1989, the ROC president signed into law a major amendment to the Banking Law.¹⁷⁰ Article 52 now authorizes the MOF to issue regulations governing the licensing of banks. On April 10, 1990, the MOF promulgated new regulations titled "Criteria for Establishment of Commercial Banks," (Criteria) dealing with the licensing of new private banks. From April 12, 1990, to October 12, 1990, the MOF accepted a total of nineteen applications for licenses. On June 26, 1991, the MOF announced fifteen new bank licenses would be awarded.¹⁷¹

The standards that the new private banks must meet are contained not only in the Criteria, but also in the revised Banking Law. Article 25 of the Banking Law now provides that a single investor will not be permitted to own more than 5 percent of a bank's total shares outstanding.¹⁷² This is presumably to prevent control over banking resources from being concentrated in the hands of private parties outside government control.¹⁷³ Banks were formerly required to set aside 20 percent of earnings as a legal reserve, but this requirement has been made more stringent. Article 50 now provides that a bank must retain 30 percent of earnings as a legal reserve, and unless the accumulated reserve equals the total paid in capital, then cash dividends are limited to 15 percent of earnings for the year.¹⁷⁴

168. For a discussion of the relevance of the experience of hyperinflation, see *supra* text at notes 17–21.

169. Gold, *Entrepreneurs, Multinationals, and the State*, in *CONTENDING APPROACHES TO THE POLITICAL ECONOMY OF TAIWAN 200–01* (E. Winckler & S. Greenhalgh eds. 1988).

170. Huang & Sterling, *New Amendment Liberalizes Taiwan's Banking Sector*, E. ASIAN EXEC. REP., Aug. 15, 1989, at 8.

171. Baum, *Bankers Abound*, FAR E. ECON. REV., July 11, 1991, at 35.

172. Banking Law art. 25 now provides:

The shares issued by a Bank shall be registered shares.

Unless otherwise approved by the Central Competent Authority [MOF], the amount of a Bank's shares held by the same person may not exceed five percent (5%) of the total amount of issued shares of the Bank and the amount of a Bank's shares held by the same concerned party may not exceed fifteen percent (15%) of such total.

The term, "same person," as used herein shall mean the same natural or juridical person, and the term, "same concerned party," as used herein shall mean the principal, his/her spouse, blood relatives within the second degree and enterprises of which the principal or his/her spouse is the responsible person.

If the same person or the same concerned party held shares in excess of the above-stipulated percentages prior to the enactment of the amendment providing for such percentages, the Central Competent Authority may order adjustment within a specified period of time.

173. K. Fields, *supra* note 17, at 83–86.

174. Banking Law art. 50.

The minimum paid-in capital of the new banks must be NT\$10 billion, and capital contributions of the promoters are limited to cash.¹⁷⁵ Promoters must subscribe 80 percent of the required capital amount, while the remaining 20 percent must be offered to the public.¹⁷⁶ At least NT\$2 billion must be fully subscribed before the promoters can lodge the application with the MOF.¹⁷⁷

The high level of capital required to establish a new commercial bank serves multiple purposes: to ensure that new banks are established on a sound financial basis; to limit the number of possible applicants;¹⁷⁸ and to ensure compliance with the new 8 percent minimum risk-based capital adequacy standard set by the Basle Supervisors Committee in 1988.¹⁷⁹ Prior to the 1987 amendments, article 44 gave the MOF complete discretion in setting capital adequacy standards. Article 44 now provides that the ratio between capital owned by the bank and the assets considered risky shall not be less than 8 percent.¹⁸⁰

Effective regulation of the new, privately owned commercial banks will be a major challenge for the ROC authorities. Regardless of whether the standards in the Banking Law and accompanying regulations are stringent enough to prevent self-dealing by the management of the new banks, there remains a shortage of qualified regulatory personnel.¹⁸¹ In January 1990, the Department of Monetary Affairs (DMA) of the MOF had a professional staff of only fifty-seven to regulate all banks then in existence.¹⁸² After the applications for new bank licenses had been received, the Minister of Finance announced plans to double the staff of the DMA. Foreign banks in Taipei are helping to train these new officials.¹⁸³

Even a larger and better trained staff at the DMA, together with bank examiners from the CBC, will have a hard time keeping track of management in the new banks. The high level of capital contribution required to apply for a license effectively limited the applicant pool to wealthy industrialists. More than three-

175. Deng, Lee & Li, *Banking: Criteria for Establishment of New Banks*, ASIAN L. & PRAC., June 25, 1990, at 42.

176. *Id.*

177. *Id.*

178. Owens, *Banking Industry in Taiwan Set for More Competition*, ASIAN WALL ST. J., May 28, 1990, at 20.

179. BASLE SUPERVISORS COMM., INTERNATIONAL CONVERGENCE OF CAPITAL MEASUREMENT AND CAPITAL STANDARDS (July 1988). The standards set by the Basle Supervisors Committee have no binding force until adopted by a country. See, e.g., Norton, *The Work of the Basle Supervisors Committee on Bank Capital Adequacy and the July 1988 Report on "International Convergence of Capital Measurement and Capital Standards,"* 23 INT'L LAW. 245 (1989).

180. Banking Law art. 44 now provides:

In order to improve the financial structure of Banks, unless otherwise approved by the Central Competent Authority [MOF], the ratio between equity capital and risk assets of a Bank shall not be less than eight percent (8%). If the actual such ratio of a Bank is less than such ratio, the Central Competent Authority may prohibit such Bank from distributing dividends. Applicable regulations with respect to prohibitions on distributing dividends shall be as prescribed by the Central Competent Authority.

The scope and method of calculating the aforesaid equity capital and risk asset amounts shall be as prescribed by the Central Component Authority.

181. Baum, *supra* note 81, at 36.

182. Kaye, *Kuo Comes Out Fighting*, FAR E. ECON. REV., Jan. 25, 1990, at 53.

183. Baum, *supra* note 81.

quarters of the nineteen applications have been received from groups affiliated with major industrial or commercial conglomerates in Taiwan.¹⁸⁴ Although the Banking Law currently prohibits bank loans to "interested persons," including related enterprises, the potential for abuse is enormous.¹⁸⁵

A recent scandal involving a cabinet minister's family and local business leaders illustrates the problems involved with detecting and proving self-dealing. The scandal involved Ms. Chang Chia-yi, a thirty-four-year-old official at Tamkang University and daughter of the former Minister of Communications, Clement Chang, and one of her colleagues at Tamkang University, an associate professor of architecture. The two purchased large blocks of stock in an unlisted company at a price one-eighth the estimated value of the shares. The shares were sold to Ms. Chang and her colleague by Hualon Teijran Co., a major company listed on the stock exchange. Minister Chang's wife was a supervisor of Hualon Teijran, a position similar to director. The transaction raised questions regarding the conduct of the listed company in selling a valuable asset for one-eighth its estimated fair market price. Investigators are also trying to discover how Ms. Chang and her academic colleague managed to pay the equivalent of U.S. \$1 million and U.S. \$1.5 million, respectively.¹⁸⁶

Given the close connection between family and business relationships that is the norm in Taiwan,¹⁸⁷ and the generally low standards in accounting and fi-

184. *Id.*

185. Banking Law art. 32 (as amended through July 17, 1989) provides in relevant part that "[n]o unsecured credit shall be extended by a Bank to its own responsible person, staff members or any interested party of its own responsible person or of any such staff member in charge of credit extensions."

Art. 33 provides:

For any secured credit extended by a Bank to its own responsible person, staff members or any interested party of its own responsible person or a staff member in charge of credit extensions, the terms thereof shall not be better than those offered to ordinary borrowers.

The total amount of the aforesaid secured credit shall be as prescribed by the Central Competent Authority after consultation with the Central Bank of China.

Art. 33-1 provides:

The definition of interested parties as used in the preceding two articles shall mean:

(1) Spouse, relatives by blood within the third degree of relationship or relatives by marriage within the second degree of relationship of the responsible person of a Bank or of a staff member in charge of credit extensions by such Bank.

(2) An enterprise solely invested in by or a partnership invested in by the responsible person of a Bank, by a staff member in charge of credit extensions of such Bank or by an interested party stipulated in Item 1 of this Article.

(3) An enterprise of which more than ten percent (10%) of the total issued and outstanding shares or paid-in capital is solely or totally held by the responsible person of a Bank, by a staff member in charge of credit extensions of such Bank or by an interested party stipulated in Item 1 of this Article.

(4) An enterprise invested in by a Bank in which a director, supervisor or manager of such invested enterprise is the responsible person, a staff member in charge of credit extensions of such Bank or by an interested party stipulated in Item 1 of this Article; provided, that such investment and the holding of such concurrent positions has been approved by the Central competent Authority.

(5) A juridical person or other organization in which the representative or administrator is the responsible person of a Bank, by a staff member in charge of credit extensions of such Bank or by an interested party stipulated in Item 1 of this Article.

186. Mark, *Taiwan Government Scandal Exposes Ties between Politics and Big Business*, Asian Wall St. J. Weekly, Mar. 18, 1981, at 19.

187. Greenhalgh, *Families and Networks in Taiwan's Economic Development*, in *CONTENDING APPROACHES TO THE POLITICAL ECONOMY OF TAIWAN*, *supra* note 169.

nancial recordkeeping,¹⁸⁸ the possibility of insider trading or self-dealing by bank management is a real one. It may be difficult or even impossible for an outsider to reconstruct the chain of events in a complex business transaction where one motive of the parties was to disguise the true interest in the transaction by using junior family members as dummy parties.¹⁸⁹

C. INTEGRATING THE REGULATED AND INFORMAL FINANCIAL SYSTEMS

ROC authorities have dealt with the informal financial system both indirectly, by encouraging greater competition in the regulated financial system, and also directly, by trying to prohibit it by law. Although the informal financial system is composed of a variety of institutions,¹⁹⁰ the UICs have in recent years posed the most visible threat to the stability of the regulated financial system. Official efforts to control and diffuse the threat posed by the UICs have unfolded slowly and cautiously because of a potentially enormous political backlash when investors are forced to confront the magnitude of their losses.

By accepting funds from the public and investing them in a portfolio of real and financial assets,¹⁹¹ the UICs were clearly engaged in a form of financial intermediation similar to a bank or a mutual fund. Because of a loophole in the law, however, they were not subject to regulation by either the SEC or banking regulatory authorities such as the MOF or CBC. The ambiguous definition of "deposit" under the Banking Law permitted the virtually unregulated operation of the UICs.

188. See *infra* text section IV.B. It is common knowledge in Taiwan that people in business maintain two books: one "outside" set of accounts to show the tax authorities (*wai zhang*), which presumably understate earnings, and one "inside" (*nei zhang*) set of accounts that are presumably accurate. In some respects this system is also the case in the United States, where separate records are kept for tax accounting purposes and for general accounting purposes. When the ROC tax authorities review accounts to assess tax liabilities, a red stamp is placed on the accounts to prevent a later substitution. If a creditor is shown what the borrower represents to be the inside accounts, the creditor can at least ask to see the outside accounts and ask for an explanation for any major differences. This raises the possibility that there is also a third set of accounts, which overstates earnings, prepared for the benefit of creditors.

189. In an interview in April 1985, a foreign bank manager with many years' experience in Taiwan noted that it is not always necessary for the head of the family to rely on the filial piety of junior family members in order to hide assets in their names. If the family patriarch takes possession of the chop or signature seal of a junior family member in whose name substantial assets are kept, then it becomes difficult if not impossible for the junior family member to alienate the property without the patriarch's permission.

It is the normal practice to have the imprint of one's seal registered as one's legal signature with the Bureau of Household Registration in Taiwan. ROC Civil Code bk. I, ch. I, art. 3, para. 2 provides: "If a person uses a seal in lieu of signature, the affixing of such seal is equivalent to a signature."

190. See *supra* text at notes 57-58 for a description.

191. To the extent that the principals of UICs were not running legitimate business organizations at all, they were recycling recent deposits to existing investors as purported dividends and fraudulently siphoning off deposits for their own use. See McGregor, *Evidence Belies Company's Boast of Diverse, Profitable Operations*, Asian Wall St. J. Weekly, Nov. 20, 1989, at 22.

In 1975, when the Banking Law was completely rewritten, a provision was introduced to regulate deposit-taking activities by nonbanks.¹⁹² Commercial and industrial enterprises were permitted to receive employee deposits subject to the qualification that the principals of the business taking the deposits would be personally liable for the repayment of the amounts deposited.¹⁹³ Following the Cathay Scandal in 1985, these provisions were changed, and revised article 29 states in part: "Unless otherwise provided by law, any organization other than a bank shall not receive deposits, manage trust funds or public properties as entrusted, or engage in domestic and foreign remittances." The problem arose when companies taking what were commonly understood to be deposits styled these credits as "loans" and argued that article 29 of the Banking Law had no application. It was under this loophole that the UICs collected, according to various estimates, the equivalent of U.S. \$3–6 billion in deposits from the public.

With the 1989 revision of the Banking Law, the language of article 29 has again been substantially revised to facilitate prosecution of illegal deposit-taking,¹⁹⁴ and article 29-1 has been added. This new article provides:

Using borrowed money, accepting investments, making the depositor a shareholder or using other classifications in order to accept deposits or obtain capital from the general public by agreeing to pay or paying a bonus, interest, share interest or other regard in an excessive amount, shall be deemed the act of Accepting Deposits.¹⁹⁵

This new definition was aimed at stopping the further expansion of the UICs, which by the time of this revision had grown to enormous proportions.

Several months after the revised Banking Law went into effect the largest UIC, known as Hung Yuan or Homey, announced to its investors that their investments were frozen, but reassured its investors that the only problem was liquidity. Although it was apparent to outside observers that the UICs had been nothing but

192. The practice of employee deposit-taking by industrial and commercial enterprises was originally encouraged by ROC authorities to help businesses cope with shortages of credit. *See supra* text at notes 61–64.

193. Banking Law art. 29, paras: 1–2 (as amended through 1975) provided:

Unless otherwise provided by law, any organization other than a bank shall not be allowed to receive deposits, to manage properties of others or to act as agent in handling domestic and foreign remittances. However, this shall not apply to someone entrusted with funds while acting as a trustee, or to deposits or margin received as part of a business transaction for a commercial or industrial enterprise, or with the approval of the central competent authority, an enterprise that receives savings from its own employees.

When a commercial or industrial enterprise is to receive savings from its own employees as provided above, the responsible person shall be jointly and severally liable for the repayment of such funds. The central competent authority (MOF) may prescribe regulations for the enforcement of this provision.

194. Banking Law art. 29 (as amended through July 17, 1989), now provides:

Unless otherwise provided by law, any organization other than a Bank shall not accept Deposits, manage Trust Funds or public property under a mandate or handle domestic or foreign remittances.

Upon a violation of paragraph 1 of this Article, remedial action shall be taken by the Central Competent Authority (MOF) or the competent authority in charge of the particular enterprise, together with the juridical police authority, and the case shall be referred to the court for action. If the organization concerned is a juridical person, the responsible person shall be jointly and severally liable for the repayment of the relevant obligations.

In performing the duties stipulated above, a suspected party's accounting books and documents may be searched and detained in accordance with the law, facilities including signs may be torn down and/or other necessary actions may be taken.

195. Banking Law art. 29-1 (as amended through July 17, 1989).

Ponzi schemes that inevitably had to collapse once the new banking law shut off the flow of funds, investors fervently believed that the management of Hung Yuan would solve its problems. ROC authorities did not want the UICs to collapse precipitously, however, and thereby lead investors to blame the authorities for the collapse rather than the principals of Hung Yuan. Even though Hung Yuan was able for a while to maintain the impression that it would legalize and regularize its operations and emerge as a regulated financial institution, it eventually collapsed when the principals were arrested in 1990. Some of the principals were recently convicted and given the heaviest sentences ever handed down in a case of financial manipulation.¹⁹⁶ This crackdown on UICs should not be interpreted as the demise of the informal financial system as a whole, however, since the UICs were only one segment of the informal system.

In addition to addressing the pressing problem of the UICs, the 1989 revision of the Banking Law authorized the MOF to issue regulations expanding the scope of authorized activities of regulated banks. Commercial banks,¹⁹⁷ savings banks,¹⁹⁸ trust and investment companies,¹⁹⁹ and foreign banks²⁰⁰ may now engage in new types of banking business with only the approval of the MOF.

D. NATIONAL TREATMENT FOR FOREIGN BANK BRANCHES IN TAIWAN

On April 10, 1990, the MOF promulgated a revised version of Guidelines for Screening and Approval of Establishment of Branches and Representative Offices by Foreign Banks (Guidelines).²⁰¹ The purpose of the Guidelines is to expand the scope of permissible activities of foreign banks operating in Taiwan, to permit the establishment of more branch offices in Taiwan, and to relax the standards for establishing branches or representative offices in Taiwan.²⁰²

The expanded scope of foreign bank branch activities in Taiwan now includes taking savings deposits, lending long-term, and managing trust funds.²⁰³ The Guidelines also permit foreign bank branches to underwrite and deal in all types of securities.²⁰⁴ The ceiling for the total amount of deposits a foreign bank can receive in Taiwan has been increased from 12.5 to 15 times its paid-in capital.²⁰⁵

Foreign banks are now permitted to establish up to three branches a year in Taiwan and are given more flexibility in deciding where to locate these new

196. Mark, *Sentencing of Hung Yuan Officers Sends Warning to Taiwan Investors*, *Asian Wall St. J. Weekly*, Apr. 8, 1991, at 11.

197. Banking Law art. 71(14).

198. *Id.* art. 78(16).

199. *Id.* art. 101(15).

200. *Id.* art. 121.

201. Huang & Chen, *Taiwan Revises Regulations for Admitting Foreign Banks*, *E. ASIAN EXEC. REP.*, Sept. 15, 1990, at 19. The 1990 Foreign Bank Guidelines appear in *E. ASIAN EXEC. REP.*, Sept. 15, 1990, at 24 [hereinafter 1990 Foreign Bank Guidelines].

202. 1990 Foreign Bank Guidelines, *supra* note 201.

203. *Id.* art. 12, paras. 1-2, 10.

204. *Id.* para. 9.

205. *Id.* art. 14.

branches. The new limit of three a year is an improvement on the limitation in the 1983 version of the Guidelines, which permitted a total of only two branches, one in Taipei and one in Kaohsiung. The new Guidelines provide that the branches may be established in Taipei, Kaohsiung, or some other place agreed to by the MOF. This standard was adopted in 1986 to give foreign banks the option of establishing branches in the Export Processing Zones.²⁰⁶ The new Guidelines still restrict expansion to foreign banks that have operated for five years without a violation of the ROC Banking Law in the most recent year.²⁰⁷

The new Guidelines, while relaxing the standard for permitting a foreign bank to establish a branch or representative office, added some new requirements.²⁰⁸ One new requirement permits foreign banks to open offices in Taiwan only if the bank has had no violation of ROC banking law for the previous five years. Now, however, a foreign bank need only be among the 500 largest in the world to qualify to establish a branch. Furthermore, foreign banks may gain admittance to Taiwan by merging with a bank holding an established branch or by absorbing the branch of a wholly owned subsidiary.

The revised Guidelines represent substantial progress toward national treatment for U.S. banks in Taiwan. Although they are still subject to cumbersome regulations regarding increased branch operations and scope of business, the current standards are dramatically more flexible and fair than the rigid guidelines applied in the early 1980s.

E. PERMITTING THE FREE FLOW OF INVESTMENT CAPITAL INTO AND OUT OF TAIWAN

Although Taiwan's economic miracle was based on international trade, until very recently its capital markets were kept isolated from international financial market pressures by extensive government regulation of capital flows into and out of Taiwan. Regulations governing foreign exchange transactions and foreign investment allowed ROC authorities to exercise significant control over the type and volume of capital flows. Liberalization and internationalization of Taiwan's financial markets will require ROC authorities to relinquish this control and permit market forces, in Taiwan and internationally, to determine the content of investment decisions. In recent years, ROC authorities have taken substantial steps toward relinquishing control over capital flows, but a free market does not yet prevail.

From 1954 to 1990, direct foreign investment in Taiwan was regulated by the Statute for Investment by Foreign Nationals (SIFN).²⁰⁹ For investments to conform to the provisions of SIFN, foreign investors were required to apply to ROC

206. *Id.* arts. 7–8.

207. *Id.* art. 9.

208. *Id.* arts. 3–4.

209. Liu, *supra* note 5, at 71.

authorities for approval. Once this approval had been obtained, foreign investors enjoyed certain rights to repatriate profits and were exempt from certain regulations that applied to similar domestic enterprises. Until the early 1980s, approval was granted only to applications in conformity with official economic policy objectives, such as manufacturing for export. From the 1960s until the statute's expiration in 1990, investors could also enjoy certain tax benefits if their investment met the requirements of the Statute for Encouragement of Investment (SEI). The SEI has now been replaced by the Statute for Upgrading Industries, which relies less on incentives for manufacturing and offers different tax benefits to foreign investors.

While this complex incentive and regulatory structure still applies to approved foreign investment in Taiwan, the reform of the foreign exchange regulations has created another legal opportunity for repatriation of investments. Under the regulations governing outward remittances, foreign investors who have not obtained official approval may nevertheless remit up to U.S. \$5 million a year in repatriated profits or capital.

An offshore banking market was established in Taiwan in 1984, but it has remained small and underdeveloped.²¹⁰ The Act for Offshore Banking Operations permits the establishment of offshore banking units by banks doing business in Taiwan and was patterned after similar arrangements in Hong Kong and Singapore.²¹¹ If the restriction on the exchange of currency by offshore banking units were lifted, the offshore banking market might play a significant role in internationalizing Taiwan's financial system.

The most dramatic recent progress in the internationalization of Taiwan's financial markets has taken place not in the banking system, but in securities markets. The internationalization of the TSE began under careful government supervision in the early 1980s when foreign financial institutions were permitted to organize and offer overseas mutual funds of stocks listed on the exchange.²¹² The second phase of internationalization, permitting direct foreign investment in the TSE, was to have begun in 1986 but was delayed by officials concerned about the magnitude of speculative funds already flowing into the stock market. Finally, in the summer of 1990, the Minister of Finance announced that certain designated foreign investors would be allowed to make direct investments in the TSE.²¹³

The Regulations Governing Securities Investment by Overseas Chinese and Foreign Investors and Procedures for Remittance have been amended, but the scope of the amendments is still quite limited and the response by foreign

210. Clinton & Hewes, *The Offshore Banking Law and the Foreign Investor*, E. ASIAN EXEC. REP., July 15, 1985, at 9.

211. *Id.*

212. Liu, *Securities Market-Opening Measures: An Analysis*, E. ASIAN EXEC. REP., Jan. 15, 1991, at 9.

213. *Id.*

investors has been less than that envisaged by the authorities.²¹⁴ Only substantial banks, insurance companies, and fund management companies are permitted to participate in the program, and investment may only be in designated instruments.²¹⁵ Total foreign ownership of TSE companies is subject to ceilings, and all investment under the program is subject to a ceiling of U.S. \$2.5 billion.²¹⁶ Inward remittances to fund participation in the program must be made within a limited period following approval of an application to participate, and outward remittances are also severely restricted.²¹⁷ The new program is clearly designed to operate as a pilot program to allow ROC officials time to prepare for expanding securities markets further. Since the current program is subject to so many restrictions, it will be of interest only to a limited number of foreign investors.²¹⁸

IV. Some Realism about the Internationalization of Banking in Taiwan

The ROC legal system is contained within a matrix of social and political institutions, and its ability to support reforms aimed at liberalizing and internationalizing the financial system will depend in part on its coherence and integrity as a part of this larger social matrix. Enacting statutes aimed at liberalizing and internationalizing the financial system may be difficult because the ROC legal system is not well-developed and its autonomy is often subject to strong pressures from other social or political institutions. Until the development of an autonomous, authoritative legal system is included in reform agendas, the appearance of liberalization or internationalization will be belied in fact.

Since in the 1970s, and at an accelerating pace since martial law was repealed in 1987, the ROC government has been moving away from authoritarian rule in Taiwan. As the KMT relies less on Leninist political strategies and military power to guarantee its continued rule, politics and society in Taiwan are opening up to an unprecedented degree. New institutional arrangements will have to be forged to replace one party rule and martial law, but there is no guarantee that those institutions will be legal institutions. Japan, the former colonial ruler of Taiwan from 1895 to 1945, continues to exert a powerful influence and Japanese economic and political practices may offer an alternative model for Taiwan to follow. Taiwan might successfully imitate the Japanese system of informal bureaucratic alternatives to litigation and legalistic economic regulations. If Taiwan follows the Japanese example, it might, like Japan, forestall almost indefinitely the creation of an autonomous, authoritative legal system while still enjoying continued economic development.

214. Mark & Levingston, *Foreign Fund Managers Criticize Taiwan Move to Attract Investors*, Asian Wall St. J. Weekly, Sept. 24, 1990, at 31.

215. Liu, *supra* note 212.

216. Mark & Levingston, *supra* note 214.

217. Liu, *supra* note 212.

218. *Id.*

A. ENHANCING THE CREDIBILITY OF THE
LEGAL SYSTEM THROUGH THE
CREATION OF A MULTIPARTY DEMOCRACY

Although the political system of Taiwan is now in the process of rapid transformation,²¹⁹ it historically has been largely a one-man, one-party dictatorship. Under such a dictatorship, the legal system has had limited importance in comparison to security organs, the executive branch of government, and the ruling party.²²⁰ The KMT sowed the seeds for resistance to its authority in 1947 by suppressing a local popular uprising with heavy loss of life.²²¹ Following the KMT retreat to Taiwan in 1949, an uneasy compromise evolved in which the majority Taiwanese population was permitted economic opportunities in exchange for continued domination of the government and military by the minority mainland Chinese refugee elite.²²² This benevolent dictatorship began to evolve toward a liberal democracy in the 1970s with the policy of Taiwanization—the promotion of local Taiwanese to positions of responsibility in the government and KMT.²²³ President Chiang Ch'ing-kuo's repeal of martial law on July 15, 1987, represented only one of many steps the ROC authorities had taken since the 1970s to reform their autocratic rule on Taiwan. The progress toward democracy is not complete, however, and the KMT continues to manipulate the political system to maintain its rule in the face of increasing political opposition.²²⁴ As a result, the political system in Taiwan may never evolve into a U.S.-style multiparty democracy, but instead may come to resemble the Japanese dominant party system.²²⁵

Although the political opposition was legalized in 1988 and reorganized as the Democratic Progress Party, it still suffers from several important disadvantages compared to the ruling KMT.²²⁶ In elections, the KMT enjoys preferential access to mass media because all television and radio stations are government-owned and KMT controlled. There have been allegations of KMT vote buying and vote fraud in recent elections. While the Election and Recall Law prohibits formal

219. Mark, *Taiwan's Ruling Kuomintang Approves Proposed Constitutional Amendments*, Asian Wall St. J. Weekly, Apr. 1, 1991, at 1.

220. Winckler, *Institutionalization and Participation on Taiwan: From Hard to Soft Authoritarianism?*, 99 CHINA Q. 481 (1984).

221. Taiwanese people rose up to protest the mismanagement and corruption of the KMT-installed military governor, who took over after the Japanese ceded Taiwan back to the Chinese. See G. KERR, *FORMOSA BETRAYED* (1965).

222. T.J. Cheng, *Democratizing the Quasi-Leninist Regime in Taiwan*, WORLD POLITICS, Apr. 1989, at 481–82.

223. T. GOLD, *supra* note 2, at 114.

224. McGregor, *Time for Political Cooperation in Taiwan*, Asian Wall St. J. Weekly, Dec. 11, 1989, at 13.

225. Baum, *Top Gun, Loose Cannon*, FAR E. ECON. REV., Apr. 11, 1991, at 24.

226. McGregor, *New Election Laws in Taiwan Squelch Opposition Efforts*, Asian Wall St. J. Weekly, Feb. 20, 1989, at 1; *Election Hearings*, *supra* note 13, at 7.

campaigning until ten days before the election, KMT incumbents are able to circumvent this restriction. On the eve of an election, the KMT has the ability to move members of the armed forces, its strongest supporters, to different residences to permit them to vote in elections where opposition candidates appear likely to win. Finally, because the ROC claims to represent all China, more than half of all elected representatives do not run for reelection at all because they claim to represent parts of mainland China where elections cannot be held. Until the KMT permits free and fair elections, the ROC government will remain more accountable to the mainlander minority, the KMT, and the military than to the public at large. Attempts at liberalizing or internationalizing the banking system will be undermined by these distortions in the legislative process.

The political pressure undermining the autonomy and impartiality of the legal system is further increased by the fact that the KMT is not just a political party, but one of the largest "private" investors in Taiwan. The KMT has cemented its dominant position on Taiwan by making substantial investments in almost every sector of the local economy.²²⁷ One recent estimate by an opposition politician of the value of government and KMT controlled assets was U.S. \$380 billion. This base of economic resources permits the KMT to supplement its diminished control over the electoral process with patronage benefits. It can influence the nature of legislation by granting monopoly licenses to government-controlled entities. This issue has been raised in the context of banking reform because the KMT is among the applicants for one of the new commercial bank licenses, a move that has sparked considerable public controversy.²²⁸ Until the KMT divests itself of its substantial economic holdings, political opposition will remain at a severe disadvantage, and the process of formulating official economic policy will be tainted by the possibility of self-dealing.

Although in some respects, the ROC political system resembles that of the United States, Taiwan also has close historical, social, and economic affinities with Japan. The Japanese political system may offer a model that can more easily be adapted to the current circumstances of Taiwan than the highly legalistic, multiparty system of the United States. The dominant party political system of Japan, in which the Liberal Democratic Party has enjoyed uninterrupted rule since World War II, achieves representation of different interests by building coalitions of different factions within the ruling party, rather than alternating the party in control.²²⁹ The legal system in Japan does not play the same role in mediating between the government and the people that the U.S. legal system plays. The exchange of ideas and the exercise of power instead take place through informal channels through a practice described as "bureaucratic infor-

227. *Taipei Moves to Trim Its Business Empire, but the KMT's Critics Aren't Appeased*, Asian Wall St. J. Weekly, Oct. 9, 1989, at 17.

228. Baum, *Nationalist Asset?*, FAR E. ECON. REV., Sept. 20, 1990, at 70.

229. G. CURTIS, *THE JAPANESE WAY OF POLITICS* (1988).

malism.”²³⁰ Bureaucratic informality consists of practices such as “administrative guidance” and a preference for mediation and informal negotiations rather than litigation or codifying and limiting government policy through formal regulations. The Japanese legal system plays a marginal role at best in articulating and enforcing government policy.

While bureaucratic informality has apparently facilitated economic growth in postwar Japan, it can constitute a serious obstacle to liberalization and internationalization of the domestic economy. The recent scandal involving major securities firms in Japan reimbursing only selected clients for trading losses highlights how substantial the differences are between economic regulation conducted through bureaucratic informality and economic regulation conducted through more formal legalistic means.²³¹ The confidence of investors in the integrity of the Tokyo stock market has been eroded by disclosures that the largest brokerages in Japan favor certain customers by compensating them for their losses, apparently with the knowledge and acquiescence of officials at the Ministry of Finance. The scandal has brought to the surface practices that were apparently routine, but shielded from public view in part by informal regulatory practices. Foreign investors have responded by calling for greater fairness and transparency in Japanese securities industries dealings, which would presumably include more formal regulations, fewer informal negotiations and compromises, and more rigorous enforcement of existing regulations.²³²

Several important changes will have to take place in Taiwan before the Japanese practices of bureaucratic informality and dominant party democracy could be implemented. Under martial law, the ruling party in Taiwan enjoyed considerable autonomy from local political conflicts.²³³ With the repeal of martial law and the opening up of civil society in Taiwan, the KMT is now being forced to find new channels of communication between the central government and local interests. Patronage systems that formerly operated at the local level will have to be reformulated into national factions, and the processes of negotiation and compromise will have to be regularized. The difficulties experienced by KMT candidates in 1989 elections demonstrated how inadequate existing systems of patronage and corruption have become in meeting the challenge of a more open political system.²³⁴ The continued dominance of the KMT in Taiwan will depend on how successfully party leaders are able to forge new alliances with local business interests, and develop practices similar to the Japanese “administrative guidance,” which facilitates informal, behind-the-scenes cooperation between bureaucrats, politicians, and business interests.

230. F. UPHAM, *LAW AND SOCIETY IN POSTWAR JAPAN* (1987).

231. Rowley, *Umpire and Coach*, FAR E. ECON. REV., July 25, 1991, at 59.

232. *Id.*

233. K. Fields, *supra* note 17, at 65.

234. Kaye, *Bad Losers*, FAR E. ECON. REV., Aug. 31, 1989, at 15.

B. ESTABLISHING THE INSTITUTIONAL INFRASTRUCTURE FOR SOUND FINANCIAL MARKETS

Financial markets are administered by people, and the professionalism and training of those individuals are essential elements in maintaining the integrity of those markets. Taiwan suffers from a severe shortage of accounting and legal professionals with the type of training that would qualify them to help develop and liberalize local financial markets. Not only does the number of qualified professionals need to be raised, but the standards that those professions apply need to be reexamined.

The poor reputation suffered by the accounting profession in Taiwan is due in part to a shortage of qualified personnel and to the incomplete specification of the standards to be applied. A 1983 survey indicated that as many as 80 percent of local CPAs were retired military or government personnel with training and experience in accounting for governmental entities, not private businesses.²³⁵ The problem of a large number of CPAs with qualifications not directly relevant to the expansion of private sector finance is compounded by an artificially low pass rate on the CPA examination for students graduating from Taiwan's regular business faculties.²³⁶ The professional standards of the accounting profession are low because legal liability is unlikely to result from certification of false or misleading financial statements.²³⁷ Systemic tax evasion within the private sector can only be maintained through cooperation between accountants and managers, and a profession of underground accountants has emerged to meet the demand for keeping duplicate books.²³⁸ Even reputable accountants have only vague standards with which to work, as evidenced by the National Federation of CPA Associations of the ROC's published accounting and auditing standards, which total only thirty-four pages, as compared with thousands of pages for the U.S. equivalent.²³⁹

A flow of reliable information between participants is necessary to the development of a modern banking system. Until the accounting profession expands the number of qualified CPAs and raises its professional standards, financial

235. Shao, *Taiwan: CPAs under fire*, Asian Wall St. J. Weekly, June 27, 1983 (originally cited in R. WADE, *supra* note 2).

236. The pass rate increased from 1 percent in 1980 to 20 percent in 1989. J.M.M. Li, *Disorder in the Counting House*, in FINANCIAL AND INVESTMENT YEARBOOK, ROC 1991, at 122.

237. According to one foreign accountant doing business in Taiwan, a local bank sued a local accounting firm for negligently having certified a false financial statement. The court held that because the bank had not relied exclusively on the financial statement, the accounting firm could not be held liable even though the statement included false information. While under ROC law, judicial decisions do not generally have precedential value and are not usually published, this accountant recalled that the defendant accounting firm took the unusual step of mailing copies of the judgment to various parties to inform them of the holding.

238. Wou Young-Ie, *The Informal Sector in the Construction Industry in Taiwan: A Case Study of an Informal Contractor* (1982) (unpublished M. Arch. thesis, U.C. Berkeley).

239. R. WADE, *supra* note 2, at 269.

markets in Taiwan will be forced to continue to operate with only inadequate and imperfect financial information.²⁴⁰

Until recently, the legal profession in Taiwan, like the accounting profession, was understaffed and dominated by retired military personnel. The majority of licensed lawyers in Taiwan today received their training in the military. Taiwan has several methods to gain admission to the bar, and historically, passing the bar exam was by far the most difficult. Until 1989, the pass rate hovered around 1 percent of the approximately 3,000 students who sat for the exam each year.²⁴¹ Other methods include service as a military officer with legal responsibilities after having received training from the law faculty of a military college, or earning a Ph.D. in law and teaching in a law school for a designated period of time.²⁴² While lawyers with legal training in the military will be well-equipped to handle a law practice based on litigation and lobbying, such lawyers will not generally be well-equipped to cope with a sophisticated transactional practice. Recent moves to permit the brightest graduates of Taiwan's regular law faculties to pass the bar exam represent a significant concession toward creating a bar capable of handling sophisticated financial transactions.

The ROC legal system seems poorly integrated into the fabric of society in Taiwan, and the shortage of legal personnel is only partially responsible. From a cynical perspective, the ROC legal system seems designed not to encourage compliance with the law, but rather to embody a threat of official sanctions that can be manipulated by various actors to secure economic or political advantages.²⁴³ Legislation is often based on inflexible formal standards demanding more compliances than can reasonably be expected. An example of this exists in a provision of Company Law stating that no incorporated entity can engage in activities that have not been specified in its articles of incorporation and approved by the relevant authority.²⁴⁴ In practice, local authorities are often unwilling to grant permission for a wide range of economic activities for which there is public demand. To circumvent the law, a company will seek permission to engage in a form of business activity that will be readily permitted (selling refreshments, for example) and then proceed to engage in whatever business seems likely to be profitable (a *Karaoke*²⁴⁵ parlor, for example). This inflexibility contrasts with

240. One indication of the magnitude of the problem is the recent estimate by the chairman of the Environment Foundation that the revenue of informal or underground business in Taiwan was equivalent to 55 percent of the gross national product of the ROC. *Taiwan's Black Market Rides Roughshod Over Local Economy*, BUS. TAIWAN, May 21-27, 1990, at 1.

241. The pass rate for the annual bar examinations administered in 1989 and 1990 increased to approximately 10 percent.

242. In recent years, the procedure for converting an academic law qualification into admission to the ROC bar by teaching in a law school has been tightened up.

243. For a similar interpretation of the role of law in modern Japan, see F. UPHAM, *supra* note 230.

244. Company Law arts. 6, 129.

245. *Karaoke* is Japanese for "empty voice," and is the name of a type of sound system developed in Japan in the 1960s. A *karaoke* system includes a microphone and background music, and was

equivalent provisions in the company law of most American states, where a company can incorporate with the stated intention of engaging in any lawful business.²⁴⁶

Confronted with rigid standards out of conformity with social reality, those charged with enforcing the law have the option of overextending resources to achieve compliance, disregarding the law, or bargaining with those affected to waive its provisions unofficially, possibly in exchange for some private benefit. A rigid legal system that incorporates few flexible standards and that appears, in many instances, not designed to be enforced, reinforces the extralegal influence of government officials. Reforming the ROC legal system to take account, for example, of the ideas of the U.S. Legal Realist Movement²⁴⁷ of the 1920s and 1930s would substantially erode the extralegal discretion now enjoyed by ROC government officials. The extralegal discretion currently exercised by ROC officials lacks even the checks and balances present in the Japanese system of bureaucratic informality. While Japanese statutes are often drafted as aspirational statements, as the concrete import of regulation is worked out in informal negotiations, ROC statutes often simply fail to conform to reality and any cooperation between regulatory personnel and the public is carried on at a level even more obscure than that of "administrative guidance" in Japan.

C. EFFECT OF LACK OF DE JURE SOVEREIGNTY

No issue of national policy is ever simple in Taiwan, because the ROC is not a nation like other nations. Both the PRC and the ROC claim to be the sole legitimate government for all of China. Although ROC claims to retake the mainland have been abandoned in recent years, the PRC has never renounced its option to use force to reunite Taiwan with the mainland. The ROC enjoys diplomatic relations with a dwindling number of small nations, and the few remaining significant powers that recognize the ROC are now reconsidering their position.²⁴⁸

The ROC has shown considerable flexibility in its diplomatic policy in recent years, but the PRC has been slow to follow suit. In his inaugural statement, ROC President Lee Teng-hui announced that his government would be willing to engage in academic, cultural, economic, and technological exchanges with the

originally used in nightclubs where individuals would take turns performing for the audience. See, e.g., Zibart, *Adventures in Dining*, Washington Post, Apr. 12, 1991, at N10. Karaoke bars in Taipei have many small rooms with comfortable chairs and large-screen televisions, and patrons request music videos with background music and subtitled lyrics that they sing along with in the company of a few friends.

246. MODEL BUSINESS CORP. ACT § 3.04 (1990).

247. W. TWining, KARL LLEWELLYN AND THE REALIST MOVEMENT (1973).

248. In 1990, Saudi Arabia recognized the PRC, leaving South Africa and South Korea as the only significant official allies of the ROC. Singapore was considering switching recognition to the PRC. Baum, *Shifting Sands*, FAR E. ECON. REV., Aug. 2, 1990, at 49.

PRC if the PRC would implement a democratic political order, establish a free market economic system, and renounce the use of force to retake Taiwan.²⁴⁹ The ROC now permits its citizens to visit the mainland with few restrictions, having lifted a ban on such visits in 1988. The ROC authorities also tacitly acknowledge a growing trade with the mainland conducted indirectly through Hong Kong affiliates. Furthermore, an ROC delegation attended the 1989 meeting of the Asian Development Bank in Beijing, even though there has been no official cessation of hostilities between the two countries.

Overtures by President Lee Teng-hui to Communists on the mainland have produced only ambivalent responses. In 1990, the Communists initiated large-scale troop movements in the Fujian province across the Taiwan straits from Taiwan. The PRC Central Bank ordered China's financial institutions to halt business dealings with the Bank of Tokyo after the Japanese bank opened a representative office in Taipei in May 1990. The Bank of Tokyo had been the first Japanese bank to open an office in Taiwan in thirty years. Dai-ichi Kangyo Bank, which has had an office in Taiwan since 1959, has no presence on mainland China as a result of the PRC's policy.²⁵⁰ Further, the PRC continues to oppose ROC membership in international organizations such as GATT.

The authority of the ROC legal system is undermined not only by domestic political pressures, but also by the lack of *de jure* sovereignty. Until now, ROC authorities have managed to navigate the uncharted waters of Taiwan's unique international status with success, but political decisions within Taiwan are always made with the specter of an invasion from the mainland in mind. If Taiwan were a sovereign nation, then political democratization and liberalization of the economic order could develop, subject to the constraints of domestic opinion and the international economic order. One internal political agenda that might emerge in an open political system would be the demand for full national sovereignty, perhaps as the Republic of Taiwan. Given the ambivalent attitude of the Communists toward Taiwan generally and the repeated assertions that PRC leaders will not permit Taiwan to become an independent sovereign state,²⁵¹ KMT authorities have not been willing to permit open discussion on this point.

Not only is democracy in Taiwan undermined by the threat of invasion from mainland China. The threat of invasion also appears to have undermined the loyalty of some ROC government officials. Given that the Communists have indicated a willingness to negotiate with the KMT, but not with a sovereign government of Taiwan, many residents of Taiwan fear that KMT leaders would sell out Taiwan in exchange for Communist support for their continued dominant position. Another fear is that the ROC government would not mobilize to resist

249. H. Chiu, Constitutional and Political Reform, in *The Republic of China and Taiwan-Mainland Relations* (Apr. 12, 1991) (paper presented at Association of Asian Studies Annual Meeting).

250. *China Stops Business with Tokyo Bank*, ABA BANKING J., Sept. 1990, at 8.

251. CENTER FOR TAIWAN INT'L RELATIONS, *LET TAIWAN BE TAIWAN* 61-71 (M. Cohen & E. Teng eds. 1990).

a serious threat from the mainland. While it is against government policy for ROC government officials to obtain "green cards" (permanent resident status in the United States), many local observers believe the practice is widespread. Furthermore, the same government officials may have followed the common practice of sending children to countries like the United States for education, or having close relatives settle and purchase real estate in foreign countries. The risk of having a government staffed with individuals holding permanent residence status in foreign countries, or having family and property in those countries, is that if faced with a serious possibility of invasion, the government would crumble and disappear. The perception that government personnel lack a sincere commitment to the long-term well-being of Taiwan and the Taiwanese people undermines any disposition to work for long-term financial or legal institutional development. This perception may be assuaged, however, by the recent announcement of a multibillion-dollar plan to upgrade Taiwan's infrastructure.²⁵²

The primary goal of political leaders in Taiwan is not simply to liberalize and internationalize Taiwan's economic order, but to preserve Taiwan's existence in its current form. Given how successfully Taiwan has coped with the problems arising from the lack of *de jure* sovereignty, it remains possible that Taiwan will continue to achieve remarkable economic results and that the financial system of Taiwan will be more fully integrated into Taiwan's international success.

V. Conclusion

The current changes in banking and finance in Taiwan are only part of a larger process of social and political transformation now taking place. Under an official policy to liberalize and internationalize the financial system of Taiwan, the ROC authorities are taking slow steps toward reform. The question of how committed ROC authorities really are to this policy cannot be answered without considering what kind of system ROC authorities and the people of Taiwan will develop for regulating Taiwan's future development. The outcome of larger political questions, such as what form Taiwan's emerging democratic institutions will take, will determine much of the outcome of more specific questions of economic regulation such as how vigorously internationalization will be pursued in financial markets.

ROC authorities need not necessarily follow the U.S. model of multiparty democracy and independent, highly developed legal institutions in order to deliver a rising standard of living to the people of Taiwan. Informal techniques of bureaucratic cooperation with business leaders applied in postwar Japan have produced sustained economic growth and political stability. Yet society in Taiwan differs substantially from both the United States and Japan, and neither model of economic development could be implemented without major changes taking place in Taiwan.

252. Mark, *Taiwan's Premier Hau Hopes to Make Historical Mark with Massive Projects*, Asian Wall St. J. Weekly, Feb. 18, 1991, at 2.

Society in Taiwan has been labeled "chaotic" and "anarchic" by some observers.²⁵³ Strong allegiances to family groups undermines loyalty to other institutions, such as the nation or a corporate employer. Subethnic rivalry between Taiwanese and Mainlanders²⁵⁴ and lack of de jure sovereignty further undermine a sense of common destiny such as the Japanese share. Substantial new avenues of cooperation will have to be developed before the ROC officials can hope to enjoy the sort of compromise and cooperation that government officials in Japan can expect. On the other hand, ROC legal institutions lack the popular support and heritage of independence and integrity enjoyed by legal institutions in the United States. Having been first a colony of Japan and then ruled by martial law, Taiwan lacks a history of democratic political institutions to draw on in building a vital multiparty democracy. Existing local patronage systems could develop into organized national intraparty factions along the lines of the LDP in Japan more easily than they could develop into a vigorous participatory democracy. With no tradition of democracy to sacrifice, the Taiwanese public may be willing to acquiesce in continued elite rule if that elite is able to continue to deliver a rising standard of living without a return to overt political oppression to remain in control.

If Taiwan develops a system of law and government similar to that of Japan, then formal regulations will not play a decisive role in determining the future development of financial markets. ROC officials in cooperation with local business elites could retain effective control of the regulatory process, diminishing the ability of small local investors or foreign participants to have much impact on significant decisions. As is arguably the case in Japan, the veneer of internationalization may serve to obscure the informal exercise of discretion rather than to permit greater access for the Taiwanese public and foreign participants.

Whether the ROC authorities try to follow the example of the United States or that of Japan, some significant changes will have to take place in coming years in order for the financial system to meet the needs of Taiwan's continued economic development. The existing bifurcated approach of overregulation of major banking institutions and underregulation of the Taiwan Stock Exchange and the informal financial system will only serve to inhibit Taiwan's further development. What Fields has labeled a policy of "public restrictions, private disregard" or what the *Economist* has labeled "a murky half-light between freedom and state control" will have to be displaced by new institutional arrangements for financial regulation.²⁵⁵ Whether the two approaches are synthesized in a legalistic approach consistent with genuine internationalization or an informal approach that will continue to exclude foreign participation remains to be seen.

253. Tanzer, *Taiwan's long march toward democracy*, FORBES, Apr. 3, 1989, at 48.

254. The largest subethnic group in Taiwan are the Taiwanese, settlers who came from mainland China in the 18th and 19th centuries and speak the Hakka Chinese dialect. "Mainlander" refers to the refugees from the Communist defeat on the mainland, who came to Taiwan around 1949, speak the Mandarin dialect, and who historically have dominated the ROC government and the KMT.

255. K. Fields, *supra* note 17, at 143; *ECONOMIST*, Mar. 28, 1987, cited in K. Fields, *supra* note 17, at 144.