Taiwan's Restrictions on PRC Investment – A Sleeping TPP Issue?

BY PAUL J. CASSINGHAM

Controversy rages in the United States over the likely fate of the Trans-Pacific Partnership (TPP). The TPP was signed on February 4, 2016, but to take effect it must be ratified by at least six of the signatories, including the United States and Japan. U.S. President Obama has written that the TPP would level the playing field in international trade by setting the highest enforceable standards and removing barriers to exports. On the other hand, Rep. Sander Levin, the ranking Democrat on the House Ways and Means Committee, has denounced the TPP, asserting that it would lock in weak standards, uncompetitive practices, and a system that does not broadly spread the benefits of trade. Many thoughtful commentators are somewhere in between.

Taiwan is not a signatory to the TPP, but there is broad consensus in Taiwan that if TPP takes effect, it is essential that Taiwan join. In her inaugural speech, President Tsai Ing-wen announced Taiwan's intention to "actively participate" in the TPP, echoing former President Ma Ying-jeou's statement this past January that Taiwan "must join." Once TPP takes effect, economists expect supply chains to shift as TPP members buy more goods from other TPP members to take advantage of reduced customs duties. Thus, if it does nothing to gain membership, an export-driven economy like Taiwan will lose overseas customers to suppliers from TPP countries. This loss would be particularly severe if Korea, one of Taiwan's strongest competitors, joins the TPP ahead of Taiwan.

The Taiwan government has begun to prepare for the revisions to laws and regulations to meet TPP requirements. Last year the Executive Yuan (EY) asked each ministry to identify which laws and regulations would need to be changed. Although the EY has not released its full analysis to the public, in April it disclosed a summary listing many of the laws to be revised, including the Statute for Control of Cosmetic Hygiene, the Postal Act, the Electronic Communications Law, the Pharmaceutical Affairs Act, the Agro-Pesticides Management Act, the Fisheries Act, and the Patent, Trademark and Copyright Laws, among others.

This so-called "gap analysis" is a good start toward identifying some of the specific changes necessary for Taiwan to join the TPP, but perhaps because of the manner in which the analysis was prepared, the result focuses more on sector-specific changes than on more general, economy-wide changes. Among the broadest and most sensitive changes Taiwan may need to consider is its restrictions on investment from the People's Republic of China (PRC).

Taiwan generally offers an open and welcoming environment for foreign investors. Foreign investment in Taiwan companies requires foreign investment approval, but most investment applications are approved routinely unless the investor proposes to invest in one of the small number of industries on the government's negative list or unless the investment is politically sensitive.

On the other hand, investors from China face a very different and much stricter investment policy. Under the Act Governing Relations Between the People of the Taiwan Area and the Mainland Area (the "Cross-Strait Statute"), a PRC company may invest in a Taiwan company or set up a Taiwan branch only if it obtains special approval from the Ministry of Economic Affairs and only if the investment is consistent with the restrictions and limitations on Taiwan's "positive list" for investment from China. Because the "positive list" is quite narrow, Chinese investment in most of Taiwan's economy is illegal. Significantly, these restrictions under the Cross-Strait Statute apply not only to a PRC company, but also to a company incorporated elsewhere that is more than 30% owned by PRC companies or citizens.

The investment chapter of the TPP specifies detailed government commitments protecting foreign investment coming from other TPP members. In general, a TPP member must treat a foreign investor from another TPP member as well as it treats its own domestic investors. If a TPP member violates this commitment, the foreign investor can even take that government to arbitration and recover compensation for any damages it suffers as a result of the violation.

The TPP contains a major exception to this broad obligation. A TPP member may deny TPP investment benefits to an enterprise from another member that is "owned or controlled" by persons from a non-TPP country. At first glance, this exception might appear tailor-made for Taiwan's restrictions on PRC investment. But is it? The TPP text does not define "owned or controlled." Would other TPP members allow Taiwan to exclude, for example, a U.S. or Singaporean company from TPP investment benefits because it has a greater than 30% – but less than 50% – PRC shareholder? Or would they regard that exclusion as excessive interference with their own policies permitting PRC investment in their companies? Would they, in fact, object that allowing Taiwan to exclude any company with a greater than 30% PRC shareholding sets an unfortunate precedent by distorting the normal meaning of "own or control?"

Taiwan faces a significant risk of PRC interference in its effort to join the TPP. The PRC is not a TPP signatory, but many commentators speculate that the PRC could influence various TPP signatories to oppose Taiwan's membership. If Taiwan mounted a vigorous defense of its existing PRC investment restrictions, would that increase this risk, serving as a lightning rod for objections to Taiwan membership?

On the other hand, could Taiwan somehow turn this challenge into an opportunity – diffusing potential PRC opposition by helping Chinese companies take advantage of TPP indirectly through Taiwan? If Taiwan were to join the TPP, a Taiwan/China joint venture incorporated in Taiwan would potentially be entitled to TPP benefits. If Taiwan also adjusted some of its restrictions on PRC imports and extended some of its TPP tariff reductions to the PRC, PRC investors might see an incentive to support – or at least not oppose – Taiwan's TPP bid.

Taiwan's restrictions on PRC investment serve a variety of strategic and economic goals. Those goals won't change as a result of TPP, but if TPP takes effect Taiwan may need to significantly adjust its approach to PRC investment restrictions, both to gain admission to TPP and to take maximum advantage of membership. That issue could dwarf the more sector-specific changes Taiwan would need to make to become TPP-compliant.

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TPP Article 9.15 states:

1. A Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of that other Party and to investments of that investor if the enterprise:
   (a) is owned or controlled by a person of a non-Party or of the denying Party; and
   (b) has no substantial business activities in the territory of any Party other than the denying Party.
2. A Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of that other Party and to investments of that investor if persons of a non-Party own or control the enterprise and the denying Party adopts or maintains measures with respect to the non-Party or a person of the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Chapter were accorded to the enterprise or to its investments.