The Ministry of Economic Affairs on Thursday published a draft amendment to the Measures Governing Investment Permits to the People of the Mainland Area (□□□□□□□□□□□□□□) for public review. It is to collect public opinion over the following 60 days before convening a cross-agency meeting to finalize any changes and implement the amendments.

The amendment aims to eliminate the substantial influence of Chinese capital on Taiwanese companies and prevent sensitive national security information and technology patents from falling into China’s hands.

At a time when Taiwan is rolling out the red carpet for more foreign companies and returning Taiwanese firms to invest in the nation amid changing global macroeconomic and geopolitical circumstances, the government is moving to redefine the status, proportion and structure of Chinese investment, and to close the loopholes that could be used by investors to skirt regulations on Chinese capital.

It has become urgent for the nation to tighten the rules on Chinese capital in light of the National Security Law that Beijing imposed on Hong Kong last month. The law has shaken the territory’s “one country, two systems” foundation and blurred the boundary between Hong Kong capital and Chinese funds.

According to Article 3 of the measures, any company with more than 30 percent direct or indirect Chinese ownership, or those at which more than half of the board directors are Chinese, is considered a Chinese company.

However, some Chinese companies have been found to have invested in Hong Kong or foreign companies and continued to reinvest in other such firms until the ratio of Chinese shareholding in the subsidiaries fell below 30 percent so that they would be regarded as non-Chinese capital in Taiwan.

It is not uncommon for Chinese capital to come to Taiwan under the guise of Hong Kong or other foreign investment.

The draft amendments would include a “layer-by-layer” review mechanism to thwart attempts to dilute apparent Chinese shareholding through repeated reinvestment. It would also bar companies run by the Chinese Communist Party, government or military from investing in Taiwan, the ministry has said.

China’s attempts to bolster its economic influence around the world has come under increasing scrutiny by other governments. The ministry’s move follows tighter investment regulations for Chinese firms in the US, Japan and Germany.

However, there is the question of whether Hong Kong capital can still be regarded as foreign capital following the implementation of the National Security Law. The territory has long served as a springboard for Chinese capital to enter Taiwan, with many Hong Kong-registered companies receiving funds from China or their top management being inseparable from China.

While the amendments seek to tighten the controls on Chinese capital, the new rules would still be based on investor status, shareholding proportion and boardroom structure, which would make it difficult to distinguish Hong Kong capital from Chinese funds.

The ministry is correct in wanting to shore up Taiwan’s financial defenses in light of the situation in Hong Kong and China’s military threats against Taiwan.

However, the government risks finding itself in a bind: On the one hand, it must address the problem of Chinese funds entering the nation under the guise of Hong Kong investment, while on the other it should find a way to distinguish genuine Hong Kong-based investment from Chinese capital. A one-size-fits-all approach is not the solution.

It can avoid such a regulatory impasse by bolstering the review mechanism for Hong Kong capital and requiring a higher disclosure obligation for investments from the territory.

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