

Export control update from China: legislation, control lists and enforcement



China's export control regime has been a source of great interest since its government first announced impending amendments. Here, Johnny Xie takes stock of developments in 2022.



LEGISLATION

For the implementation of the Export Control Law ('ECL') promulgated in 2020, the Ministry of Commerce ('MOFCOM') promulgated the Regulations on Export Control of Dual-Use Items ('Draft') for public comment on 22 April 2022. Though most of the contents are duplicates of the ECL, the Draft does have some new features that deserve attention.

Control code

For those familiar with US or EU export control regimes, the first challenge in trying to understand China's export control system lies in the fact that its dual-use control list uses the Harmonised System ('HS') code rather than ECCN/ECN to identify the controlled items.

It is rarely possible to undertake a like-for-like

THE AGENCY WANTS TO GIVE THE TRADE COMMUNITY A TRANSITION PERIOD TO GET PREPARED BEFORE THEY HAMMER DOWN WITH FULL STRENGTH.

mapping between HS code and ECCN, which means items classified into one ECCN may be classified into several HS codes and vice versa. Moreover, the HS was created by the Customs community for the regulation and statistics of tangible goods, while intangible technologies and computer programs constitute a significant portion of dual-use items.

This leads to an interesting phenomenon: In China's dual-use control list, tangible items usually have HS codes attached as a classification reference while intangible items do not. The inconsistency and inconvenience are a problem for businesses that want to learn and comply with China's export control regulations. However, in Article 13 of the draft, it is stipulated that a control code will be introduced and added to the items on dual-use control list.

Types of licences

Licences and licensing are an essential part of an export control system. As a common practice, countries with established export control regimes include different types of licences for different scenarios, such as individual licences and bulk licences. The more granularity the licences have, the more accurate the controls are.

In addition to individual licences, the Draft introduces general licences to facilitate regular dual-use exporters' compliance efforts, setting the use of established and effective internal compliance programmes as one of the conditions.

Licence exemption

The Draft lists three situations where licence exemptions can apply:

1. Dual-use items returned to the original place of export after entering China for repair, testing, or inspecting within a reasonable period of time;
2. Dual-use items returned to the original place of export immediately after participating in exhibitions held within China;
3. Outbound civil aircraft parts for overhaul.

Details about the exemption process are to be determined.

Controlled Entity List

MOFCOM set out a description of the Unreliable Entity List on 19 September 2020, targeting entities that stop supplying the Chinese market for discriminatory or unjustified

reasons. Unreliable entities are subject to the following penalties:

- a. restricted or prohibited from engaging in import and export activities related to China;
- b. restricted or prohibited from investing in China;
- c. restrictions or prohibitions on the entry of relevant persons, means of transportation, etc.;
- d. restriction or revocation of work permits, stays, or residence status of relevant persons within the territory of China;
- e. imposition of fines according to the seriousness of the circumstances;
- f. other necessary measures.

The Draft defines Controlled Entities as those who violate ECL and are subject to the following penalties:

- a. to prohibit all or part of the exports to the entity;
- b. to deny the relevant licence application;
- c. to withdraw the licences that have already been issued;
- d. to suspend the exports that have not yet been completed;
- e. other necessary measures.

Report obligation

The most significant provisions that call for compliance actions are Articles 27, 30, and 36.

Article 27 is a typical catch-all control, which requires exporters to apply for a licence when they export unlisted/uncontrolled items on condition that they know, have reason to know, or being informed by authorities that the items to be exported have the following risks:

- a. endangering national security and interests;
- b. being used in the design, development, production or use of weapons of mass destruction and their means of delivery;
- c. being used for terrorist purposes.

Additionally, where an exporter discovers within three years after the completion of the export that the exported goods, technologies or services have the aforementioned risks, it

shall promptly report to the competent authority.

Article 30 requires the exporter or the importer to report in a timely manner to the competent authority if the end user or end use of the exported dual-use items has changed or may change. If the items have not been exported yet or just partly exported, the export process shall be suspended immediately.

Article 36 imposes a reporting obligation on third parties providing agency, freight, delivery, customs declaration, third-party e-commerce trading platform, financial or other services for exporters engaged in dual-use export.

Where one of those aforementioned parties discovers that an exporter is engaged in illegal export conduct, they shall immediately stop providing services and report to the competent authority.

Obviously, the report obligation requires exporters to constantly and closely monitor the end use and end user of their exports, which is very challenging in practice.

ENFORCEMENT TREND

In China, MOFCOM is the competent authority in charge of export control of dual-use items. The ECL has mandated the agency to investigate and penalise export control violations, which not only grants the enforcement power but also enumerates different types of violations and defines penalties for each of them. Theoretically, MOFCOM just needs to identify the violation, fit it into the appropriate type, and proceed with prosecution. However, in the past two years hardly any enforcement cases can be found in public records, which indicates that it really takes time to build enforcement capacity.

It seems that the Customs administration, as a veteran of supervising and controlling imports and exports, feels more comfortable and confident in enforcing ECL. Public records show that since the enactment of ECL, China Customs has initiated and closed over a dozen cases.

Administrative

Most cases have resulted in administrative penalties. The legal basis upon which China Customs imposes administrative penalties includes the 'Administrative Punishment Law', 'Administrative Compulsion Law', 'Customs Law', and 'Regulations on the Implementation of Customs Administrative Penalties'.

Administrative penalties usually take the following forms:

- a. Warning or public criticism.
- b. Fines, confiscation of unlawful gains, and confiscation of illegal property.
- c. Temporarily withholding licences, lowering authorisation levels, or revoking licences.
- d. Restricting production and business operation activities, ordering the suspension of production and operation, ordering closure, or restricting engagement in certain business.
- e. Administrative detention;
- f. Other administrative penalties stipulated by laws and administrative regulations.

In those cases, the most frequently-quoted provisions are Article 34 of ECL and Articles 14 and 15 of Regulations on the Implementation of Customs Administrative Penalties, which deal with the violation of exporting controlled items without a licence and no subjective intention.

For the violation, Article 34 of ECL stipulates a fine of not less than five times but not more than ten times the illegal business turnover if the illegal turnover exceeds ¥500,000; where there is no illegal business turnover or the illegal business turnover is less than ¥500,000, a fine of between ¥500,000 and ¥5 million shall be imposed. Articles 14 and 15 of Regulations on the Implementation of Customs Administrative Penalties suggest a fine of between 5% and 30% of the shipment value. Obviously, Customs rules are much more lenient than ECL in

terms of penalties for the same kind of violation. For all the actual cases examined, fines imposed by China Customs were between 5% and 30%.

Referring to ECL but punishing in line with Customs regulations, the phenomenon implies that the agency wants to raise public awareness of ECL compliance and at the same time to give the trade community a transition period to get prepared before it hammers down with its full strength.

Criminal

According to Article 21 of the Interpretation of the Supreme People's Court and the Supreme People's Procuratorate on Several Issues Concerning the Application of Law in the Handling of Criminal Smuggling Cases, if without permission, importing or exporting goods or articles that are restricted from import or export constitutes a crime, it shall be convicted and punished as the crime of smuggling goods and articles prohibited by the state in accordance with Articles 151 and 152 of the Criminal Law.

Therefore, exporting controlled items without licence, if the behaviour constitutes a smuggling crime, the violator will be convicted and punished in accordance with the crime of smuggling goods and articles prohibited by the state, where the Criminal Law stipulates that the violator shall be sentenced to fixed-term imprisonment of not more than five years with/without fines if the violation is deemed normal; and shall be sentenced to fixed-term imprisonment of not less than five years with fines if the violation is deemed serious.

According to China's export control legislation, exporting sodium carbonate (Na_2CO_3 - a chemical precursor listed in dual-use control list) to certain countries such as Myanmar, Laos and Afghanistan requires a dual-use export licence. In one of the criminal cases, a man called Hu wanted to export sodium carbonate to Myanmar but he did not have the required licence. He then falsified the destination of his shipments and managed to export more than

300 tons of sodium carbonate to Myanmar. Upon conviction, Hu was sentenced to two years' imprisonment, suspended for two years, with a fine of ¥100,000. As an accomplice, Hu's freight forwarder was sentenced to one and a half years' imprisonment, suspended for one and a half years, with a fine of ¥50,000.

COMPLIANCE PERFORMANCE

From enactment to enforcement, the compliance of ECL is gaining its momentum. In the past, when I helped companies review their export compliance performance, the assessment was usually conducted against standards set

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by US and EU export control regimes. Now, more and more companies are asking me to examine their operation from ECL's perspective.

Below are some typical issues shared by a number of companies across different industries.

Classification and identification of controlled items

As discussed earlier, China's dual-use control list is HS code based rather than ECCN based. This spells a significant challenge when companies accustomed to ECCN try to identify whether items are subject to ECL via classification process. Moreover, there are many items on the dual-use control list that are designated according to China's national perception and judgement, which may not be subject to control in other jurisdictions. For example, the sodium carbonate smuggled in the criminal case.

The majority of reported offences were committed simply because the violators did not know that the items exported by them were subject to export control.

Insufficient management commitment

Regular audit is an important element recommended by most countries for an effective internal compliance programme. However, my assessment shows that some multinationals only conduct audit for the compliance of US or EU export regulations. This self-blinding approach to the ECL is risky, and poses risks to such companies' China-related business.

Companies have allocated limited resources in terms of personnel and budget to ECL compliance work, which is often disproportionate to the size of a companies business operations in China.

Insufficient resources usually lead to poor training and

education, which in turn leads to poor compliance performance.

Apt to take shortcut

It is not uncommon that companies are taken aback when they realise how much they need to spend in building an effective export control compliance system. Instead of investing time and money in research and development, they tend to copy the institution and practice from others.

There is an analogy between compliance assessment and seeing a doctor. No matter how experienced and knowledgeable a doctor is, careful diagnosis is always indispensable before giving patient the prescription. The doctor cannot omit the diagnosis and duplicate the prescription for all because each patient is unique. Similarly, companies differ from each other in many ways such as product, customer, and business model. In the realm of export control compliance, a short-term shortcut is a long-term trap.