Growth In Global Export Controls Could harm Tech Industry

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"*A free and open economy is the foundation of global peace and prosperity*."
—Japanese Prime Minister Shinzo Abe, June 2019

On July 1, only few days after Japanese Prime Minister Shinzo Abe opened the G20 summit with a speech endorsing an open global economy, the Japanese government announced that it will impose tighter controls on technology-related exports from Japan to South Korea for reasons of national security. The controls may have a devastating effect on trade between the two countries and will create further drag on the world economy.

The Movement of Technology: A Changing Landscape

We imagine you are not surprised to hear of new export controls designed to prevent the spread of knowledge. The new Japanese export control measures are part of a larger trend in which countries are building walls around foreign access to their technology.

Export control regulations are nothing new — the U.S. government passed the Trading with the Enemy Act in 1917 — but the recent trend of nationalism is throwing up fences at a time when the world's technology development is more interwoven across borders than ever. The United States has increased its technology controls both through foreign investment scrutiny and export control enhancements.[1]

One of the new regulations in this trend may have some unexpected effects — at least, it may take some U.S. consumers by surprise. The regulation is a proposed Chinese export control law that would establish that country's first comprehensive and unified export control legislation. The Chinese Ministry of Commerce stated that the proposed measures were justified by what it termed "international obligations."

In the Ministry's view, the bill containing the export restrictions is intended to comply with China's obligations as a permanent member of the United Nations Security Council and as party to a number of international treaties on the control of nuclear, biological and conventional weapons.

China's Proposed Controls: A Tech-Tonic Shift

We note that there is no guarantee that the bill will be passed into a law anytime soon. The bill is still in its draft form and it remains to be seen how the legal provisions will be enforced, whether any exemptions will be introduced and if there will be any significant updates to the bill before it passes into a law. Though, considering the actual context of international trade war, and the fact that China recently released its version of an entity list,[2] there is reason to believe the bill may be enacted before the end of this year.

The bill looks a lot like the current U.S. export control regimes. It sets forth four categories of controlled items including:

• Dual-use items which may be used for civilian and military purposes;

• Military items;

• Nuclear items; and

• Other goods, technologies, services and items that are related to national security.

The bill also introduces a requirement to obtain government licenses — which would be issued by the Chinese State Council together with China's Central Military Commission — for carrying out controlled activities.

Depending on how the controls are implemented, it is possible that certain software and technology, including encryption, and certain hardware, including semiconductors, could be subject to licensing requirements. That could mean that your iPhone — which is designed in California, but manufactured in China — may need a license just to get out of China.

The penalties for exporting goods, software or technology from China without the appropriate license could result in some substantial penalties:

• An administrative penalty of up to 10 times the illegal business revenue or a fine of up to 500,000 Chinese Yuan ($72,690) could be imposed if the illegal business revenue is less than 50,000 Chinese Yuan ($7,269) and

• Any illegal income could be subject to confiscation.

Persons directly in charge and other persons directly held liable — not expressly defined, but may include employees or agents of the exporter — may also be given a warning and fined up to 300,000 Chinese Yuan ($43,611). More serious violations could also lead to criminal charges.

In addition to those penalties for export without the appropriate license, the bill also provides that Chinese authorities may withdraw the license of any party obtained by fraud, bribery or other unlawful means or of any party that falsifies, alters, leases, lends or sells a license for the export of controlled items and may impose other substantial fines.

Additionally, items falling out of the scope of the proposed control lists could also be temporarily controlled for up to two years, subject to the approval of Chinese authorities. Those same items would also be controlled as soon as the exporter knows or has reason to know that the export would lead to national security concerns.

The bill grants the authorities significant investigative powers. For instance, the authorities would be able to enter the business premises of parties under investigation for violations of export control rules, conduct interviews, access relevant documents and seize assets or bank accounts of a wrongdoer. That section of the law could give Chinese investigators significant powers to look into the inner workings of foreign companies through their Chinese presence.

Addressing the Changes: Stay Informed, Stay Nimble

The proposed Chinese export control legislation is still in draft form. It remains to be seen how the provisions will be enforced, whether any exemptions will be introduced or if there will be any significant update to the bill before it is passed into law. However, global companies should take note of the potentially broad impact of the proposed bill. They should also be clear-eyed about the construction of new barriers to the free exchange of technology and goods around the globe.

Technology companies — and the know-how they control — are viewed more and more as critical national security assets of their respective countries. The geopolitical interactions of those countries will almost certainly pull and press the companies that span their borders. With significant changes happening now, and more changes almost certain to come, large companies may need something like their own state department.

Ok, maybe not a whole department, but companies would be well advised to invest in resources that can keep them up to date on the only thing that we can be certain of in today's global economy: that everything changes.

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[1] For more discussion, see our International Tech Investment Issue, https://www.globaltradelawblog.com/?s=%22international+tech+investment+issue%22+

[2] See https://fortune.com/2019/06/18/china-entity-list-huawei/