E Compliance Insights:
A Pacific E Compliance Newsletter
March 2021

PACIFIC E COMPLIANCE

The United States-China Trade War Heats Up

New Trade Restrictions Between China and the US Create Headaches for Exporters and Users of High-Tech Equipment and Technology

As China and the United States position themselves for global influence and geopolitical power, the impact is felt deeply in trade. First came tariffs. Then restrictions on the flow of certain equipment and technology. Now comes the proliferation of new lists, further restricting trade. This article will examine three of those lists – China's Non-reliable Entity List and the new US Communist Chinese Military Companies and Military End-User lists. We will also look at the US's additional restrictions on the export of emerging and foundational technology.

One of China's economic strategies has been to require foreign companies who wish to do business in China to take on a local partner. The foreign company would then be required to transfer the technology used to create or manufacture the products or supply the relevant services. Foreign companies were willing to do this as the price of getting access to the vast Chinese domestic market and China's cheap and uniquely skilled labor force and supply chains. The international companies expressed little concern as they believed their technology would always be a step ahead, and the trade-offs made sense. China successfully used this strategy to quickly gain expertise in numerous technologies, from telecom equipment to oil production to smartphones.

China's strategy may have run its course as the US, and other nations impose increasingly restrictive trade barriers. The creation of new trade restriction lists is a stark reminder. But first, a brief discussion of the broader restrictions on the export of emerging and foundational technology.

ECRA and FIRRMA. After Trump lost the 2020 election, his administration proposed new rules for restricting the transfer of emerging and foundational technologies to China. These new restrictions are required by the Export Control Reform Act of 2018 (ECRA) and the Foreign Investment Risk Review Modernization Act (FIRRMA).

ECRA imposes new restrictions on emerging technologies such as precursor chemicals used in chemical weapons and viruses that could be used in biological weapons. ECRA also identifies emerging technologies such as highly specialized machine tools, silicon wafer technology, and geospatial imagery artificial intelligence. All of these technologies can form the basis for the new generation of military weapons and technology. All now require a license for export to most countries, including China, with an exemption for goods subject to and traded within the Australia Group.

FIRRMA aims to achieve a similar result (restrictions on export or sharing of sensitive US technology) via restrictions on the investments foreign companies can make in the US or with US companies. Suppose the investment target is a US company with emerging or foundational US technology. In that case, the acquisition is subject to review and potential blocking by the Committee on Foreign Investment in the United States (CFIUS). The ECRA and FIRRMA are highly complex and technical and challenging to apply. Generally, companies with these issues should work with trade lawyers and other specialists.

The Communist China Military Companies List (CCMC list) went into effect on January 11, 2021. The law itself is relatively simple – US persons, after a one-year divestment period, cannot invest in the stock or other publicly traded securities of companies that are listed on the CCMC list. The intent is to prevent CCMC listed companies from raising money by selling stock or other securities, money they can then use for military purposes. The concept is straightforward; the roll-out was not. In response to the new rules, the esteemed New York Stock Exchange stated it intended to delist the PRC Telecom Company subsidiaries, then reversed its decision four days later, then reversed its decision again seven days after that. All in response to changing rules and guidance from the then Trump administration. The dust has now settled with about 45 companies on the CCMC list. The list is expected to grow.

The Military End-Use List – Yet another new list. The US Department of Commerce created the Military End User (MEU) list in December 2020. This list places export controls on numerous items destined for "military end-use" or a "military end-user" in Russia, China, or Venezuela. The original tranche consisted of 58 Chinese companies and 45 Russian companies. Exporters that desire to ship specified equipment, including relatively low-level equipment such as mass-market encryption hardware and software and parts for commercial aircraft, will require a license if to a military end-user, including those on the MEU or for a military end-use in the specified countries. There is no de minimis exception. Most license applications will likely be denied. The MEU puts additional burdens on companies that export even low-level technology to China, Russia, or Venezuela.

The Unreliable Entity List – Not to be outdone, China has established a new list of its own – the Unreliable Entity List. The list appears to be something of a cross between OFAC's sanctions list, the Department of Commerce's Entity List, and EU blocking legislation. A company can find itself on the list if the company 1) endangers China's national sovereignty, security, or development or 2) ceases business with a Chinese enterprise for non-commercial reasons, e.g., ending business with a Chinese entity to comply with US sanctions. Designated companies can be restricted or banned from importing to or exporting from China, investments in China, entry into China, revocations of work permits for employees, fines, and "other necessary measures".

Take-Aways – To state the obvious, this is all very complicated. Companies engaged in trade with both China and the US will face increasing complexity complying with two systems trying hard to make trade difficult. It is still possible to make trade with both. We hope that we will not come to a fork in the road where companies have to choose one or the other. But prudent companies will develop a back-up plan for that scenario, should it come.

That time has not come yet. Despite the added complexities in the past six to twelve months, trade between China and the US remains robust. According to the non-partisan and well-respected US Congressional Research Service, in 2019, the US exported $106.6 billion worth of goods and equipment to China. Only about 0.5% required a US export license. Approximately 0.001% were military items. The vast majority of exports either required no license or qualified for a license exception. Although the rules are becoming more complex, commerce continues.