

Additional Opinion Brief on China's Draft Export Control Act

Title: Opinion Submitted Regarding Export Control Act (publicly released draft)

Destination: Department of Treaty and Law, Ministry of Commerce

Center for Information on Security Trade Control (CISTEC)
Japan Machinery Center for Trade and Investment (JMC)
Japan Foreign Trade Council, Inc. (JFTC)
Japan Electronics and Information Technology Industries Association (JEITA)
Japan Business Machine and Information System Industries Association (JBMIA)
Japan Chemical Exporters and Importers Association (JCEIA)
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The Japan Chamber of Commerce and Industry (JCCI)

In response to the request for public comment on the Export Control Act (Public Draft) issued in June of this year by the Department of Treaty and Law, Ministry of Commerce, People's Republic of China (PRC), members of Japan's industrial sector submitted an opinion dated July 13 through the CISTEC, an entity whose members comprise the principal exporting companies in Japan and that specializes in security trade control.

Subsequently, the principal economic organizations in Japan involved with trade and investment in China had an exchange of views among themselves. They concluded that with respect to those points of interest to the Japanese industrial sector it would be desirable to convey in greater detail their concerns about the system as presented in the draft and its operation as well as the impact it would have on the trade and investment environment as a whole. Accordingly, we have put together this additional Opinion Brief.

The present Opinion Brief reflects the consultations held with the relevant departments and bureaus in the aforementioned principal economic organizations in Japan.

The Opinion Brief already submitted by CISTEC included its opinions, questions, and desires based on the view that China is a nation that has a major status in the global political economy and strives to execute its international obligations under a spirit of international cooperation, and based on the perspective that is generally welcoming of the effort to develop a system of export control laws while regarding mutual agreements with the international community as crucial.

Subsequently, the principal industrial and economic organizations in Japan had a further exchange of views among themselves regarding the content of the Public Draft. It became clear that, owing to the shortness of the period of time for accepting public comment at just one month and the need for specialized knowledge to understand export control systems, the corporate and industrial sectors involved in trade and investment with China had by no means developed an adequate understanding of the Draft's content and impact. We cannot even say that people were fully aware that the Draft itself existed.

We are deeply concerned that, should the work on drafting this legislation move forward in a short time-frame under these conditions and the act be promulgated and put into force, it could lead to great confusion among the enormous numbers of companies and individuals involved with trade and investment in China.

Additionally, the present draft includes more than a few elements to its system that differ from those of the usual export control systems of the sorts agreed to under the international export control regime. These include elements that may be thought of as problems from the "Level Playing Field" perspective widely accepted as a general principle when it comes to export control systems. We are gravely concerned that these elements eventually could become factors that would greatly inhibit China's trade and investment environment.

As supplement to the Opinion Brief submitted in July that also includes these views, we now submit the Additional Opinion Brief and requests that follow. We ask for your forbearance as some elements may duplicate the opinions that have already been submitted. There are parts that may seem to be criticisms. However, that is not our intention. We hope you will understand that we present them from a perspective of seeking mutual benefit for China and Japan and encouraging further trade and investment between our two countries and also others.

1. Necessity of Arrangements That Have Had Adequate Time for Alerting Industrial Sectors Everywhere and Stepwise Implementation of Regulations

(1) Adequate publicity regarding work of drafting legislation and insuring opportunities for exchange of views with domestic and foreign industrial sectors

We believe that the Public Draft has been reviewed by considering opinions submitted during the solicitation for public comment as further investigations aimed at giving it definite form have proceeded. However, this has received limited coverage in the mass media. Furthermore, despite being a bill that will have a major impact on economic relations, there

are many people connected with the business sector who are not aware of the existence of the draft. If the work on drafting the legislation were to proceed under these conditions, we believe that this would inevitably invite great confusion later.

In particular, the present Draft would implement new regulations on dual use commodities and technologies related to conventional arms. Naturally, there is no problem with the introduction of regulations itself that are generally implemented under the international export control regime. However, dual use commodities and technologies related to conventional arms are very different from those related to weapons of mass destruction (WMDs), and an extremely far-reaching range of civil use products and technologies will become regulated. Aside from the fact that these include numerous products produced and exported by domestic and foreign companies alike in “the World’s Factory” that is China, it could also target products and the like including those in new technological domains in which start-up companies are planning to conduct research and development, manufacturing, and export activities in China. Furthermore, it would have a major impact on the current daily practices of trade and investment and in the future. There are also concerns that in some cases the need that would emerge to revisit product development in order to comply with Chinese export control laws, the draft law could not only lead to increased costs for the company trying to manufacture its products in China and export them but also become a cause for quality problems to develop that would be inherent to China.

Furthermore, in the event that work goes forward on crafting and enacting this legislation without ensuring the concerned parties fully understand and are prepared for the possibilities that this state of affairs may produce, it cannot be denied that deep and widespread confusion could arise in the industrial sector stretching across all industries.

Furthermore, as discussed earlier that confusion would have a major impact on the trade and investment environment for China as well and at the very least would be greatly detrimental. Given this, we believe it all the more necessary to pull together extensive opinions and questions that are based on a full understanding of the Draft’s content to serve as material for consideration in the work of drafting legislation.

For these reasons, we ask that information be released once again about the existence of the Public Draft and its contents, and that opportunities be guaranteed for a broad and continued exchange of opinions. Furthermore, we also ask that venues be arranged for receiving an explanation of the plans and enforcement methods for the Draft including its intent, its content, the formulation of its detailed rules and guidelines, its enforcement, and plans for putting it into practice. These may be accomplished through explanations provided to organizations from foreign countries and foreign affiliated companies involved with trade and investment in China, and through briefings in the principal countries around the world

that have close trade and investment relations with China.

(2) Securing an Adequate Extension after Detailed Information Made Available and Stepwise Implementation of Regulations

Regarding regulations, the industrial sectors involved cannot make preparations without not only the law itself but also the details of how it will operate being made clear. For example, it is not possible to make the preparations for coping with license systems without clarity regarding such points as—

- The differences in how Individual Licenses, Global Licenses, and License Exceptions are handled,
- What sorts of favorable treatment are offered based on the standard of autonomous control, and
- How Country Groups are classified based on what sort of standards.

Once these points are clarified, the industrial sectors can study the impact on their supply chains related to China and take the necessary steps. In particular, the regulations regarding dual use items related to conventional arms target a wide range of products and technologies. Just those companies that have actually advanced into China still comprise an enormous group and range in size from major concerns to SMEs. Furthermore, they have supply chains that are spread out all through China and elsewhere in the world. For example, even an SME that manufactures components in Japan and supplies them to a Japanese product manufacturing company may not even fully understand Japan's export regulations. In order to achieve an understanding of the regulations' content that includes these companies and ensure they take appropriate measures, we believe that in some cases the preparations will require an appreciable amount of time in units of years. Furthermore, one can fully conceive of a situation in which numerous problems arise while work on specific responses is moving forward. A careful response will be necessary so that this does not interfere with foreign trade or encouraging investment.

Given this reality, we ask that an adequate grace period be guaranteed after the details have been settled, and also ask for consideration be given to introducing these regulations in a stepwise fashion rather than all at once.

2. Reexamination of Systems That Could Become Major Hindrances to the Trade and Investment Environment —Need for Systems Conforming to the “Level Playing Field” Principle

Security export control systems are necessary for guaranteeing international peace and security. In keeping with it being one of the pillars behind the intent of putting together the Public Draft, ensure smooth international cooperation by devising links with international statutes is regarded as necessary.

At the same time, the notion of the Level Playing Field is regarded as a common principle of export controls. This principle arises from the concern that if a system operates in a fashion that deviates from the globally shared systems and operations grounded in the consensus in the international export control regime, the competitive conditions for the companies and industrial sector in the country in question will be at a disadvantage compared to those from other countries. It holds that this situation should be avoided.

It is normal for the industrial sector and regulatory authorities in each country to hold repeated discussions about rationalizing regulations and so forth in order to achieve more effective export controls. This is something that is mutually understood as a principle upon which they should be based at that time.

There are concerns that systems and operations that deviate from internationally common systems and operations will interfere with the smoothness of normal corporate activities and create an enormous burden for companies. Japan's industrial sector also works to draw out issues from companies with respect to regulations and their operation, holds discussions with the regulatory authorities, and works to rationalize them so that the legal systems and their operations are appropriate.

Viewing the Public Draft from these perspectives, we sense that it is clearly detrimental in light of the Level Playing Field principle from the point of view of Chinese companies including foreign affiliated companies that operate in China, and also that it includes systems that we fear may be greatly detrimental to the trade and investment environment in China.

The primary issues here are the re-export controls and the deemed export regulations. These are not systems that are generally agreed upon under the international export control regime. They can be described as idiosyncratic systems. Creating an idiosyncratic system that differs from the international export control regime in the areas of international trade and investment presents a great stumbling block from the perspective of preserving a favorable international trade and investment environment. While we understand that a similar system has been implemented in the U.S. and serves as a specific security measure from the perspective of preventing WMD proliferation, it is also a fact that it presents both potential and actual stumbling blocks to international trade and investment. We cannot imagine it being profitable to create the same sort of system as the U.S. when it comes to achieving the objectives of expanding exports and obtaining a leading position internationally when it comes to making proactive use globally of newly created materials in strategic newly

developed industrial sectors. On the other hand, we can imagine this system having a negative effect on those policies aimed at upgrading Chinese industry by actively making the most of foreign affiliated companies and foreign engineers.

We will explain the implications in concrete terms below.

(1) Re-Export Controls

[1] Re-Export Controls as a Whole

The U.S. has re-export controls in place. However, the governments of Japan and European countries have long pointed out that these fundamentally amount to an extraterritorial application of regulations and are questionable from the perspective of international law. CISTEC has requested that they be abolished (if the country that has an appropriate export control system in place is the export destination, entrust it to the country in question).

Even setting aside their questionability from the perspective of international law, re-export controls come with numerous side effects and demerits. If it becomes necessary to obtain license from the Chinese government to re-export from an import country the products that were imported from China or products that use more than a certain percentage of parts that were imported from China, then using Chinese products will become a risk and it will create a strong incentive in industrial sectors in foreign countries to avoid using them. It will become necessary to make a point-by-point calculation of the percentage of Chinese products included based on a complex formula. Furthermore, if the relevant parties cannot determine whether a product that has been supplied through a variety of supply chains is originally a Chinese-origin product and if so whether it is subject to regulation, then they will not even be able to calculate the percentage that originates from China. The system in the U.S. currently does not oblige that export destinations be notified about whether an item is subject to regulation, and has problems in terms of its effectiveness. However, if even so the parties involved were to make a maximum effort to track down a products place of origin and whether or not it is subject to regulation, it would require an enormously burdensome procedure. That alone would create a powerful incentive to avoid the use of Chinese products. Even if it was put into use, companies would make a group effort to reduce their use rates of the designated Chinese-origin products. If burdens of this sort are produced for a large number of products, companies are likely to begin studies to find suppliers outside of China.

On this point, a similar situation has in fact arisen with respect to the U.S. re-export controls. The European aerospace sector has made an explicit effort to avoid using U.S. products. Furthermore, considering CISTEC's public call for the abolition of re-export controls, the Bureau of Industry and Security (BIS) at the U.S. Department of Commerce in 2009 issued

a call for public comment regarding the impact of re-export controls on U.S. products. CISTEC sent the BIS the public comment based on a questionnaire taken of its member companies information about the tremendous burdens that come with the U.S. re-export controls and showing that a majority of respondents said they avoid procuring U.S. products if they can obtain substitute goods from other countries.

Given that situation, cross-sectional nationwide manufacturing groups in the U.S. have also held talks with representatives from industrial sectors in Japan and Europe and raised issues from the perspective that the existence of re-export controls in the U.S. is detrimental to U.S. business.

The industrial sectors of Japan and Europe have experienced the heaviness of the burden that comes with the U.S.' re-export controls, and it would have a significant negative impact if China were to implement such controls together with newly introducing far-reaching export regulations on general products related to conventional arms.

[2] Re-Export Controls Regardless of Whether or Not Origin of Items is Chinese

Aside from de minimis rules about Chinese origin, in the present Draft, regardless of whether or not the origin of items is Chinese, re-exporting goods from the export-destination country would require license . However, under those condition, exporting to a third country products made using parts and materials imported from Japan, the U.S., and European and other countries (in short, not of Chinese origin) from a second country that imported those products from China would be require the license of the Chinese government.

Not even the U.S. has implemented such regulations under its system. Furthermore, if such controls were implemented, the thriving added-profit trade in which foreign affiliated companies and Chinese companies alike are involved would be greatly inhibited.

(2) Deemed Export Regulations

The clause about far-reaching deemed export regulations—a system for obtaining licenses to supply commodities, technologies, and services to foreign affiliated companies and foreign persons (persons of non-Chinese nationality) in China—also raised concerns that it might impose tremendous constraints on the activities of foreign affiliated companies in China.

The international export control regime does not stipulate that deemed export regulations be implemented as a general obligation, and no other countries has stipulated such far-reaching controls.

For example, the U.S. does impose restrictions on supplying technologies and software source codes to foreign persons (persons of foreign nationalities) in the U.S. However, it

does not do so with respect to the supply of goods or software object codes to such persons in the U.S. Furthermore, there are many exceptions regarding licenses with respect to the regulations on supplying technologies and software source codes. They strike a balance with the need to maintain the smoothness of corporate activities.

Furthermore, aside from the U.S. there are no countries that impose regulations across the board with regard to supplying to foreign persons (persons of foreign nationalities) in those respective countries. Some countries do impose regulations on supplying technologies and software to non-residents under certain conditions, but these are primarily aimed at “foreign students, trainees, researchers, and persons on business trips” not affiliated with any domestic institution.

Furthermore, no country in the world imposes regulations on supplying to foreign affiliated companies in their country. In short, because Japan, the U.S., and European countries with their varied regulations treat foreign affiliated companies in their countries the same as domestic companies, there are no regulations on supplying to them within that country and the regulations that do exist do not have a major impact on corporate activities in their respective countries.

In the case of China’s deemed export regulations in the Draft, foreign affiliated companies across the board including joint ventures and independent companies are included in the category of “foreign company” in China. They are subject to these regulations, as is everything up to technical dealings with foreign employees within a company. Additionally, if not just technologies but also the supply of commodities and services is subject to regulation, it will result in an idiosyncratic system without precedent worldwide.

If such an idiosyncratic system were to be introduced, the regulations would extend to cover all domestic dealings between foreign affiliated companies in China and Chinese companies. Our concern is that the domestic dealings that have gone so smoothly to date with no exceptional regulations in place would be inhibited. With regard to the materials used in products of foreign affiliated companies, given the ongoing increase in the proportions of Chinese-origin materials it is difficult to imagine a situation in which regulations would be imposed when procuring them. Chinese companies would also wind up having to determine in their domestic dealings whether a partner is a foreign affiliated company and assess whether the commodities and technologies they handle are subject to regulation. However, we do not think that this is realistic.

Furthermore, if dealings with foreign employees in a company were also subject to regulation, it would produce a great deal of concern that the technical briefings and discussions that take place a regular basis with executives and employees sent from the home office abroad could not be undertaken smoothly, along with such activities as accessing

an in-house database. Additionally, in the event that a company of foreign origin imported a key device, say, from their home country headquarters or a facility in some other region, it is possible that the very act of sharing that product or technology with foreign executives or foreign individuals on assignment would become subject to controls. This would prevent regular trade routines from flowing.

Given that these foreign affiliated companies are nonetheless established in China on the basis of Chinese law, we believe it would be appropriate for them to be seen as Chinese companies in the same ways how Japan, the U.S., and European countries handle such companies in their respective countries. Also, when comes to foreign persons we believe there is a need to regulate technical transfer to “foreign students, trainees, researchers, persons on business trips, and other such individuals” not affiliated with an organization that has been permitted to establish itself in China and prepare comprehensive license systems and license exceptions systems so that the regulations would not interfere significantly with normal corporate and research activities.

Furthermore, on the issue of preventing any unauthorized outflow of sensitive commodities and technologies from with an organization, it is our understanding that as a rule they are secured not with an export control system but rather through a legal system setting up a framework for protecting company secrets and a legal system for controlling unauthorized access by employees and outside parties who are not directly concerned. In Japan, such matters are regulated by a framework for protecting trade secrets based on the Unfair Competition Prevention Act.

Thus, it may be seen that re-export controls and far-reaching deemed export regulations include major elements of uncertainty for the industrial sectors from all countries that are involved with trade and investment in China. They give the impression of being pointed in exactly the opposite direction of China’s stance that it wishes to strive harder at industrial development by encouraging international cooperation and taking advantage of foreign investment.

Also, in China to date the many foreign persons in the form of engineers, management executives, and so forth have been active at foreign affiliated companies and elsewhere and contributed to the country’s industrial development. We are deeply confused about the idea of a system being introduced that would have a negative impact on that situation.

With China aiming for further development based on international cooperation, the industrial sectors of foreign countries ask that their activities in a country with that aim be stimulated all the more. We are certain that the policy of encouraging inward investment in China will continue to be important for the development of products and technologies in the

high-tech sector heralded in state plans such as Made in China 2025. Likewise, we are sure that foreign affiliated companies and foreign persons will continue to play major roles for the development of foreign trade.

Under those conditions, if a system were to be introduced in a form that deviates from the Level Playing Field principle in export control systems and is seen to be directly opposed to the direction of encouraging further reforms and opening up and of improving the trade and investment environment toward that end, we believe it would result in massive confusion among the industrial sectors of foreign countries. It is said that at present exports from foreign affiliated companies account for most of the exports from China. We believe that imposing tremendous constraints on the activities of these foreign affiliated companies that have contributed to the development of China's industry and economy by means of an idiosyncratic system that deviates from the Level Playing Field principle would be a significant demerit for China.

In the world of export control systems, achieving their legal objectives while simultaneously guaranteeing smoothness in corporate activities continue to be issues. These go beyond being just problems between regulatory authorities and the industrial sector. We believe they are issues that can also be problems between regulatory authorities and those authorities seeking to encourage trade and investment and promote industry. For these reasons, we ask that the bureau drafting the law also hold earnest discussions about the various impacts that regulatory measures would have with the industrial sectors in China and abroad and also with the various business promotional authorities. It is also our hope that a balance be struck between these issues involved resulting in regulations that do not deviate from the Level Playing Field principle in the implementation of a system that conforms to the international export control regime.

3. Necessity of Implementing Regulations Conforming to the International Export Control Regime

(1) Formulating a Controlled Items List Conforming to the International Export Control Regime

In the Draft explanation, executing international obligations and international cooperation were billed as the aims that form its central pillar. Generally speaking, countries around the world have built and operate systems that are based on the four international export control regime agreements. Even those countries that do not participate in those regimes normally have systems and practices based on them. Furthermore, the items subject to control are

shared throughout the world every year based on agreements made at regime meetings.

A tremendous burden is created when the items and technologies subject to control differ from those of the international regime agreements. The Draft explanation states that it seeks to promote links with international statutes and strengthen international cooperation. Accordingly, we strongly request that the list of controlled items related to conventional arms be brought into conformance with the control list established under the Wassenaar Arrangement (WA).

(2) Curbing Unreasonable Demands for Technological Disclosure in Export Inspections

Normally, conducting an export screening entails classifying the item and reviewing the end user and the end use. That said, when it comes to the classification made by the exporter, it is normal to defer to what the exporters themselves have made. Even if the screening authorities do make a check, they do so only when the classification made by the exporter seems suspect. There are concerns that the application of China's export control act might not conform to this international standard practice and an exporter might be constantly receiving unreasonable requests for technological disclosure from the authorities about a given product.

While large numbers of advanced industrial products such as information technology and telecommunications devices are manufactured in and exported from China, there are more than a few instances of key devices and technologies that are imported to it from foreign countries. They also include products that are exported to China after they have already been licensed based on the export control laws of exporting country. If China's export control authorities were to demand technological disclosure of these sorts of key devices and technologies that have already been properly approved for export once, it would be unreasonable from the perspective of implementing regulations that conform to the international export control regime; the industrial sector would no longer be able to procure key devices and technologies from foreign countries with any peace of mind; and as a result, it would make it difficult to export cutting-edge industrial products from China.

(3) Reexamination of Methods and Conditions for On-site Investigations Regarding End Users and Uses

The Draft stipulates on-site verification of an item's end users and uses after it has been exported. We understand the need in export controls to carefully screen for whether there are any concerns about an end user or end uses, and we can also understand the need for follow up depending on the case regarding how it is being used after export.

However, stipulating the power to conduct on-site inspections in the export destination by law would give that Law the character of making an extraterritorial application of sovereignty. Under the international export control regime, generally speaking the end-user inspection method is limited to particularly sensitive items for which there are concerns of being diverted for use related to WMDs, and, in general when obtaining export license, an end user has to file a report in the form of a promissory letter on end use that lays out how an item is being used, and when re-exporting the item under the license, they usually need to request approval from the export control authorities. Even when on-site verifications are required, we understand they are done in cooperation with the government of the country where the end user is located and using a method that strikes a balance with the requirement of international law.

From that perspective, we believe careful reexamination is necessary with respect to the methods and conditions for end-user investigations.

4. Reexamination of Elements Related to Industrial Development and Trade Policy: Necessity for Systems and Operations Conforming to the WTO

(1) “International Competitiveness” and “Supply with Regard to the International Market” and the “Equivalence Principle” as Points for Consideration Aside from “Peace and Security”

The purpose of security export controls is to secure to the utmost peace and security internationally and in the home country. Based on that common objective, other countries have put together their systems that conform to the international export control regime.

However, the sections regarding formulating a control list in the Draft stipulate points that go beyond “national security” and “international obligations” to also require giving consideration to “trade and industrial competitiveness,” “supply with regard to the international marketplace,” and “the development of technology.” We sense that these items were likely present for reasons of industrial promotion and trade policy. We believe that they are not in keeping with an export control system whose objectives are peace and security. If “supply with regard to the international market” is meant to refer to so-called “foreign availability” (the principle that regulating those items that can readily be obtained anywhere in the world is meaningless, so they should not be made subject to regulation), then we request that this intent be made clear.

We believe that export regulations based on such elements would produce connections with separate international rules regarding trade under the WTO and so forth.

Furthermore, even with regard to the “equivalence principle” that sets down taking reasonable measures against those countries that have implemented discriminatory export controls against China, we can imagine that this would create problems in connection with the international rules for solving such issues based on dispute-settlement procedures.

(2) “Protection of Important Strategic Rare Materials”

From the discussion in the Draft explanation regarding the need for drafting this law, we fully understand and welcome the items that came up in putting together export control system such as protecting national security, strengthening investigatory authority, executing international obligations, and strengthening international cooperation.

However, with respect to protecting important strategic rare materials, there are no other examples of subject materials in security export controls. Furthermore, even a research report from the Chinese Academy of International Trade and Economic Cooperation (CAITEC) written during the process speaks of the need to include rare materials in (security) export control regulations as a means of coping with the issue of international litigation.

In light of this, we imagine this might create problems even in relation to the WTO’s rules on trade and request that careful discussions be done on a government basis.