



New Information on Shenyang Machine Tool Company's Illicit Sales to North Korea and Russia

By David Albright and Spencer Faragasso

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Several years ago, the Institute reported about the relatively large, multinational Chinese company Shenyang Machine Tools Company supplying sophisticated computer numerically controlled (CNC) machine tools, equipped with Western controlled software, to North Korea in violation of UN Security Council (UNSC) sanctions and a supplier country's trade control laws that banned re-export of this software. New information details the disingenuous way in which the Chinese government investigated this case, indicating nonetheless inadvertently that North Korea received these machine tools, while also demonstrating China's utter disregard for enforcing UNSC sanctions or its own or others' export control laws. This case serves as another of the many cases highlighting China as a long-time irresponsible trading partner that responsible companies should avoid when sensitive dual-use goods are involved, lest they be complicit in outfitting North Korea's, Iran's, or Russia's military programs. Today, responsible suppliers are inadvertently facilitating Russia's prosecution of an illegal war against Ukraine. Given Shenyang Machine Tools Company's recent exports of goods to Russia with Harmonized Shipments (HS) codes found on the Bureau of Industry and Security (BIS) Common High Priority List (CHPL), this company should be considered for sanctions.

Background on the Case

According to the earlier writeup of this case,¹ a European government acquired evidence that Shenyang Machine Tools Company (SMTCL) supplied two sophisticated 6-axis CNC machine tools, containing European controlled software, to North Korea in 2015. Later, information surfaced indicating that more exports of these machines likely took place.

Shenyang Machine Tools Company, headquartered in the city of Shenyang in northeast China, is China's largest machine tool manufacturer, selling its machine tools, some highly sophisticated, in China and globally, including in Europe and the United States. It also has supplied the Shenyang Aircraft Company, which builds both military and civilian aircraft. Since 2018, SMTCL

¹ David Albright, "Shenyang Machine Tools Company," *Institute for Science and International Security*, April 13, 2017, <http://isis-online.org/isis-reports/detail/shenyang-machine-tools-company/>.

has been owned by China's General Technology (Group) Holding Co Ltd, aka Genertec, a centrally administered State-owned enterprise, which is directed by the State-owned Assets Supervision and Administration Commission of the State Council (SASAC).

Shenyang's machine tools use a range of subcomponents imported from major Western supplier nations, some of which are banned from re-export under their strategic trade control laws supplemented by international sanctions. The subcomponents at issue were from a batch shipment of control units and software licenses for 6-axis CNC machine tools. The goods are on the lists of the Nuclear Suppliers Group (NSG), Missile Technology Control Regime (MTCR), and other control lists. These goods were supplied by a high-tech firm to Shenyang Machine Tools under the condition that they would not be re-exported to North Korea or other sanctioned states out of concern that they could be used in nuclear, missile, or conventional military programs.

European government officials gathered evidence that at least two SMTCL 6-axis machine tools, containing this controlled, imported software, were exported to North Korea without re-export authorization. In short, the re-export was banned barring the approval of the European government.

Shenyang Machine Tools had strong ties to North Korea. For example, it hosted a North Korean delegation in October 2013. Evidence indicates that at the time of the re-exports it employed a person whose sales area included North Korea.

Shenyang, located approximately 250 kilometers from North Korea, has a large North Korean population. As has happened in China before, North Koreans based in China seek goods for North Korean WMD, missile, and military programs, posing as legitimate buyers pretending to use the goods within China but instead smuggling them to North Korea. However, this case was different. The evidence indicated that certain company officials knew that the end user of the controlled machine tools was North Korea. As a result, the European country wanted to investigate and, if adequate evidence was gathered, prosecute the responsible individuals at SMTCL and in North Korea for violating its laws.

Chinese Government Response

The Chinese government refused to cooperate with the European country's criminal investigation. As a result of this non-cooperation, the supplier country was unable to gather sufficient evidence to prosecute the case.

Complicating matters, such supplier countries have been hesitant to supply China with many details about illegal Chinese company exports because of China's history of lax enforcement and cover-ups of such cases. Consequently, the European country was unwilling to provide China with all of its evidence, which was apparently extensive. Events proved that the sharing of more evidence likely would not have mattered.

China did conduct an internal investigation, producing a report. The report stated that three such Shenyang machine tools, after many stops involving different consignees, did arrive at the Chinese city Dandong, at the border with North Korea. The report concluded that the end user was a small tulip trader.

The Chinese report states that the tulip trader bought three, not just two, 6-axis CNC machine tools. The tulip trader paid in cash.

The Chinese report merely stated that this sale was legal, accepting the absurd notion that this tulip trader was the end user, thereby sidestepping the supplier country's export stipulation banning re-export without authorization.

The Chinese report indicates no due diligence to locate the machine tools, identify the actual end user, or confirm that the machine tools were not shipped onwards to North Korea. While the evidence and the Chinese investigation support that these three 6-axis machine tools ended up in North Korea, the Chinese government was satisfied with the view that their final destination was a small tulip shop in Dandong, China, devoid of any storage facilities or need for such machine tools. Such is Chinese enforcement of its own exports and UNSC sanctions. The report also demonstrates China's unwillingness to cooperate with foreign criminal prosecutions, even being willing to look foolish in its justifications for that noncooperation.

Lack of Company Internal Controls

There is no indication that Shenyang Machine Tool Company was doing anything other than seeking buyers, whoever they may be. Not surprisingly, the evidence gathered by the European government further established that Shenyang Machine Tools Company and its sales agents lacked effective, robust internal compliance programs (ICPs) that can provide assurance to international suppliers that the machine tools of Shenyang Machine Tool Company are not being diverted to North Korea, and now to Russia as well. This assurance is particularly important today in light of Russia's illegal invasion of Ukraine and North Korea's growing nuclear arsenal, increased belligerence, and now direct combat assistance and involvement in Ukraine.

Recent Exports to Russia

In order to determine if SMTCL recently exported machine tools to Russia, import-export commercial trade data were searched covering the period from early 2022 through the spring of 2024. A number of exports from SMTCL, or exports of their machines, were identified.

Shipments by SMTCL. SMTCL made six shipments from September 2022 to February 2024 to Russian companies.² The shipments had Harmonized Shipments (HS) codes found on

² Five shipments listed the supplier as Genertec Shenyang Machine Tool Co., LTD, and the other was Shenyang Machine Tool (Group) Co., Ltd. Both companies are listed at the same address as SMTCL and are treated as one here.

the Bureau of Industry and Security (BIS) Common High Priority List (CHPL). The HS codes were listed on the CHPL under Tier 4.b, which covers computer numerically controlled (CNC) machine tools and components (see Table 1). Their total declared value was \$415,355.

One of the importers, LLC Mashimport (tax ID 7719717008), is judged by the U.S. Treasury Department as a secondary sanctions risk and designated by the U.S. State Department for operating or having operated in a sector of the Russian Federation economy found to support Russia's military-industrial base. Although the shipment preceded Mashimport's designation, the war was ongoing and the and the Russian military's need for machine tools were well known.

Table 1. TIER 4.B Exports by SMTCL to Russia

<i>HS Code</i>	<i>SMTCL Shipments to Russia (no.)</i>	<i>HS Description and Representative Part</i>
8457.10	2	Machining centers for working metal
8458.11	3	Horizontal lathes for removing metal, numerically controlled
8458.91	1	Lathes, excluding horizontal, for removing metal, numerically controlled
8459.61	0	Milling machines, not knee type, for removing metal, numerically controlled
8466.93	0	Parts and accessories for machine tools, for laser operation, metalworking machining centers, lathes and drilling machines, etc., not specified or included elsewhere

Unique Shipments of SMTCL Machine Tools by Other Shippers. Five shipments of SMTCL machine tools, identified by the brand and valued at \$320,619, were shipped to Russia by the trading company Shenyang Machine Tool Import & Export Company. At one point, SMTCL planned to buy this company but decided not to do so in 2018.³ However, other than proximity, no corporate relationship could be established today between SMTCL and Shenyang Machine Tool Import & Export Company. The five shipments occurred from mid-August 2022 to mid-March 2024, and one involved items listed in the CHPL under Tier 4.b (see Table 1). Three shipments had HS Code 8459.39, which is a catch-all term for “other,” in the category of “machine tools (including way-type unit head machines) for drilling, boring, milling, threading or tapping by removing metal, other than lathes (including turning centers) of heading 8458.”

Three of the shipments were to two designated entities, although the shipments occurred prior to their designation, albeit well after the start of the war. OOO Trading House Stankomachstroy

³ “Shenyang Machine Tool Co., Ltd. cancelled the acquisition to acquire Zhongjie Machine Tool Co., Ltd., Shenyang Machine Tool Import & Export Co., Ltd., SMTCL Canada Inc., Shenyang No. 1 machine tool plant, Zhongjie drilling and boring machine plant, Shenyi Xisi CNC machine tool division, and aerospace industry department from Shenyang Machine Tool Co.,” Ltd., *Market Screener*, October 25, 2018, <https://www.marketscreener.com/quote/stock/SHENYANG-MACHINE-TOOL-CO--6497565/news/Shenyang-Machine-Tool-Co-Ltd-cancelled-the-acquisition-to-acquire-Zhongjie-Machine-Tool-Co-Ltd-34539237/>.

(tax ID: 5835109448) received two imports of SMTLC horizontal boring and milling machines without CNC in the second half of 2023. It was designated by the U.S. Treasury Department on February 23, 2024, for supporting Russia's military-industrial base. Promoil (tax ID: 5904112229) received low value SMTCL spare parts and was added to Treasury's Specially Designated Nationals (SDN) list on November 2, 2023.

The Russian company TD SMS Ltd. (ООО ТД СМС, tax ID: 5835109448), aka Trading Company SMS Ltd., imported two shipments on March 24, 2024, of SMTCL horizontal boring and milling machines (HS code 8459.39) made in January 2024. The total declared value of the two shipments was \$168,439. This trading company is not sanctioned, but it appears to be benefiting from the war. Its operation in 2023 resulted in the profit of 1.3 billion rubles (about \$14 million), 6.2 times more than in 2022.⁴

It should be noted that the queried trade data showed that Shenyang Machine Tool Import & Export Company made other exports, including to other sanctioned Russian entities. The items included a variety of lathes, spare parts, and machine tools and machining centers from Ironmac, Shenyang Schiess, and KMT. Sanctioned importers included LLC KMT (tax ID: 9719010156) and KAMI-Group Ltd. (tax ID: 7719429480).

Conclusion

As these cases highlight, China has been neither willing to enforce its own trade control laws or UN Security Council resolutions on North Korea and to cooperate with foreign prosecutions involving re-exports of controlled goods, nor to stop sensitive exports to Russia. This is partially explained as a product of poor awareness among Chinese industries, underdeveloped domestic trade control and sanctions legislation, and a lack of political will in the government to enforce laws that could be detrimental to economic growth. But it also reflects Chinese government hostility to these controls and international sanctions, a hostility that is increasingly aimed against the United States and its allies.

The case highlights the need for Western governments to more carefully scrutinize controlled exports to Chinese companies, such as Shenyang Machine Tools Company, obtain verified assurances from these Chinese companies that the controlled goods will not be re-exported without approval to Russia or other sanctioned countries, launch criminal investigations when violations are detected, and to apply sanctions more quickly. This is especially important since SMTCL, as part of Genertec, seeks to build advanced machine tools that can replace the need to import Western machine tools.

Without adequate Chinese cooperation or action, as has happened so often, Western suppliers should not export that item to China in the future. This was done in the case of the controlled machine tool software, at least temporarily, but neither the European Union nor the United States applied sanctions in this case.

⁴ https://www.readyratios.com/profile/1145835004545_ooo-td-sms#employees.

The United States was aware of the details of the case of the controlled software and chose to not designate Shenyang Machine Tools Company in any way. Because of the urgent need to block key exports to Russia, the United States should revisit this question.