

INSIGHTS

## Region Mulls Impact as China Solar Sanctions Loom

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A major development in Middle Eastern solar over the past two years has been the influx of Chinese engineering, procurement and construction (EPC) contractors and suppliers into the sector.

Developers have engaged Chinese contractors to construct the 2GW Al-Dhafra solar photovoltaic (PV) plant in UAE, the 800MW Al-Kharsaah solar PV plant in Qatar, multiple PV projects under the National Renewable Energy Programme in Saudi Arabia, and many other projects across the Middle East and North Africa (Mena) region.

Allegations (refuted by China) have recently emerged concerning the possible use of forced labour by Chinese solar manufacturers. The claims relate to facilities in the Xinjiang Uyghur Autonomous Region in northwest China.

As much as 45 percent of the world's polysilicon (used on most photovoltaic cells) originates from this region.

China's critics claim that the use of slave labour is a key factor in ensuring that Chinese manufacturers can offer the cheapest modules in the world.

Reports suggest that the US is considering the imposition of sanctions in response to the allegations. Ostensibly, the aim of the sanctions would be to cause China's solar industry to re-evaluate the use of slave labour. However, it would also have the effect of releasing China's hold on the global solar PV supply chain.

The repercussions of sanctions would be felt most acutely in the Middle East, with several megaprojects either under construction or at tender stage. The region has been the beneficiary of a series of world-record-low tariffs as a consequence of the availability of cheap modules from China.

In this article, we consider the nature of potential sanctions by the US, the possible impact on projects that are in the construction phase and what sanctions might mean for the regional pipeline of solar PV projects.

## **Scope of Sanctions**

The US Department of the Treasury's Office of Foreign Assets Control (OFAC) administers a number of different sanctions programmes. The sanctions can be either comprehensive or selective, and can be implemented with almost unfettered executive discretion.

There is no suggestion that the US is considering implementing the type of wide-ranging economic embargo to which Cuba and Iran are subject. Aside from the political ramifications, China is too heavily embedded in global supply chains for this approach to be effective or enforceable.

Instead, the US is likely to pursue targeted measures. Already, it has imposed sanctions against the Xinjiang Public Security Bureau and a number of state officials connected with the alleged human rights abuses against the Uighur Muslims in Xinjiang. These sanctions form part of a coordinated response to China by the US, EU, UK and Canada.

If the US decides to pursue further sanctions, these are likely to apply to those module suppliers in Xinjiang that the US considers make use of forced labour.

The effect of the measures will be to make the suppliers 'functionally radioactive' in the international marketplace. They would certainly find that any assets in the US are blocked and would be prevented from doing business with US entities.

In addition, they would not be able to attract international investment or funding, and are likely to suffer reputational harm in countries reluctant to act contrary to US interests.

## **Projects Under Development**

In a relatively short period of time, Chinese EPC contractors and suppliers have come to dominate the solar market in the Middle East. As a result, even the threat of punitive measures targeting Xinjiang has caused developers of Middle Eastern solar projects to hurriedly review their project contracts for potential liability.

Clearly, the specific consequences for each project can only be properly evaluated when sanctions are actually imposed. However, certain general principles are likely to apply.

Firstly, the developer (under a concession agreement) and the contractor (under an EPC contract) will be required to comply with laws that apply to the works or the project. The parties will need to establish the extent to which laws relating to sanctions apply.

Secondly, the parties may look for relief in respect of the imposition of sanctions. However, relief is generally provided only where sanctions are imposed directly on the country in which the solar project is located.

As is generally the case in project development, the contractual position is secondary to the practical necessity of completing the project. Regardless of the contractual terms, the imposition of sanctions would certainly cause sleepless nights for all stakeholders.

## **Market Repercussions**

Aside from project-specific difficulties, the imposition of US sanctions has the potential to be a very significant disruptor in the Middle East solar PV market.

There is no doubt that the current ultra-competitive pricing environment is predicated on the continued participation of the Chinese supply chain. The medium-term business plans of regional developers assume ongoing access to low-priced modules from China.

In the short term, the spectre of sanctions is unlikely to alter the market. The Chinese suppliers are too cheap to ignore and their products are too reliable.

In fact, many would-be competitors from Europe and India have exited the region because they cannot compete on price.

Developers would struggle to pivot to other suppliers, even if it made financial sense.

That being said, if wide-ranging sanctions do come to pass (and there is no sign of a rapprochement on the issue of forced labour in Xinjiang), they could present a significant challenge to China's dominance of the market.

In that scenario, the region will almost certainly see an increase in solar PV tariffs.

## **Outlook**

Given the focus of the Biden-Harris administration on human rights, further sanctions are a realistic outcome.

The most likely measures, targeted sanctions, will cause some localised anxiety for authorities and developers engaged on current projects with suppliers from Xinjiang.

However, a more comprehensive programme of sanctions has the potential to blow the market wide open again.