Making Xinjiang Sanctions Work

Policy Brief No. 10 – Strengthening Xinjiang sanctions

Based on *Making Xinjiang Sanctions Work*, July 2022[i]

Can economic sanctions address Xinjiang forced labour? The Xinjiang Sanctions research project seeks to answer this question. Drawing on 3 original datasets containing over 12,000 datapoints, confidential interviews and a year of research, this Policy Brief series summarises key findings from the research. For further analysis, and the references and authorities supporting the statements in these Policy Briefs, see the project's main research study at www.xinjiangsanctions.info.

The Xinjiang Sanctions Policy Brief series:

1. *Xinjiang forced labour*
2. *The XPCC*
3. *Legal considerations*
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6. *Corporate responses*
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Key research findings

- Of the 3 sectors studied (see Policy Briefs 7 (cotton), 8 (tomatoes) and 9 (solar)), the one most clearly impacted by Xinjiang sanctions is the cotton sector. Western sanctions appear to be depressing demand for Xinjiang cotton, and its price. At least one firm affected (though not directly targeted) by a US WRO and designated on the Entity List – Changji Esquel – has lost hundreds of millions of dollars in revenues, and had to close factories and lay off workers outside China. Meanwhile, Western apparel brands have clearly lost market share in China as a result of Chinese counter-measures (see Policy Brief No. 5).
- For the solar sector, there is considerable anxiety around *potential* impacts from Xinjiang sanctions, with investors increasingly active behind the scenes, and US WRO enforcement causing some disruption and delays on imports. But the price of Xinjiang polysilicon is at 10 year-highs, suggesting no overall shortage of demand. The costs of Western sanctions may thus be falling more on solar panel importers than producers.
- Finally, there is little sign – beyond withdrawal of some firms from global stock indices – of Xinjiang sanctions impacting the tomato sector to date.
- Moreover, in none of the sectors have Western sanctions yet led to clear signs of policy change, nor of remedy being provided to victims of Xinjiang forced labour. The advent and enforcement of the *Uyghur Forced Labor Prevention Act* (UFLPA) could change this situation, as could the adoption of an EU forced labour instrument.
- In all 3 sectors studied, target selection appears to have been driven primarily by information adduced to governments about the ties between individuals and entities, on the one hand, and Xinjiang forced labour programmes on the other. Targets do not appear to have been selected based on the influence they can wield over the Chinese government policies and practices that underpin Xinjiang forced labour.
- XPCC-connected firms and individuals have received the greatest focus. Other firms, which may in fact be more vulnerable to sanctions, and have greater influence over Beijing policy makers (such as Ruyi Group, COFCO Tunhe, and solar firms with ties to the Zhejiang clique) have not yet been specifically targeted.
- Only in 1 of the 3 sectors studied – the cotton sector – do market structure and cost asymmetries (the balance of costs imposed by sanctions) clearly favour importers and buyers in sanctioning states, rather than Xinjiang producers and exporters.
- The sanctioning coalition could be enlarged by recruiting states whose local producers are vulnerable to Chinese social dumping – export of goods made below relevant social and labour standards. These include Central Asian cotton producers, West African and Latin American tomato producers, and South Korean polysilicon.
- Cost asymmetries in the solar sector seem to work directly against Western importers. This could be addressed by adding a sanctions focus on high-quality quartz exports from North Carolina, and by developing coordinated transnational industrial policy to develop alternative, slavery-free supply of polysilicon.
- The success of import bans such as the UFLPA will depend heavily on enforcement strategy and resourcing. All 3 sectors show signs of emergent sanctions evasion. Where possible, customs authorities may need to supplement document-based compliance with forensic approaches such as DNA, genotype and isotopic testing.
- Sectoral bodies emerge as unexpectedly important players in the sanctions process. As sanctions theory predicts, their positions on sanctions policy are shaped by the commercial interests of their members. But this emerges as a product not just of their members' position in global markets, but also of local regulatory choices – and bodies' positions on international norms such as labour standards. Multistakeholder groups have played a key role in norm amplification and shaping market expectations on labour standards.
- Yet this has also occasioned Chinese resistance, politicizing these bodies and encouraging the emergence of rival 'local' sustainability standards and assurance processes. There is a risk here of disputes over the Xinjiang forced labour 'narrative' spilling over into technical standards processes and international economic regulation more broadly, through debates on Environmental, Social and Governance (ESG) standards.
- There is a marked difference between Western policy on Xinjiang forced labour in *trade* and in *investment*. While there is a growing interest from Western policymakers in the use of import and export controls to sever the connection between Western consumers and importers and Xinjiang forced labour, Western investors continue to operate with a relatively free hand, profiting from forced labour. The significant leverage that both investments and capital market regulation afford for addressing Xinjiang forced labour has not yet been meaningfully wielded by Western policy makers, even if individual investors are beginning to actively engage firms with possible connections to Xinjiang forced labour.

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Why is this important?

- The findings of this study raise difficult questions about the *purpose* of Western sanctions in response to Xinjiang forced labour. Are they intended to reduce forced labour, or simply to reduce the contribution that Western consumption makes to Xinjiang forced labour? If the former, then significant adjustments in strategy and implementation may be required.
- Sanctions are not being adopted in a strategic vacuum, but against the backdrop of growing rivalry between the US and China. Decisions around sanctions will be made with consideration for their impact on this broader dynamic, as well as their potential contribution to costly economic decoupling between China and the West.
- For many, the inescapable conclusion is that China is simply 'too big to jail' – too large and powerful to effectively sanction – and thus the West must reconcile itself to China's policies, or find non-coercive ways to persuade China to adjust them.
- Others see new possibilities for sanctions tradecraft, based on adoption of broad and powerful sanctions against Russia following its invasion of Ukraine.
- One key difference, however, relates to the role of the private sector. Western business has, to a remarkable extent, voluntarily withdrawn from business in and with Russia. Its willingness to withdraw from business with China, where many fortunes remain to be made, seems much less certain.
- Xinjiang forced labour thus stands in important ways as a test of the liberal character of international trade and finance. A successful defence of that character – and of human rights – will depend on finding ways to make Xinjiang sanctions work.
- The study lays out 10 Recommendations to the sanctioning coalition for strengthening Xinjiang sanctions.

Recommendations

Recommendation 1: Clarify the ask

- Sanctions literature makes clear that sanctions are most effective when they specify a precise and narrow policy change required to end sanctions. This is currently absent from Western countries' Xinjiang sanctions.
- The sanctioning coalition should develop, publish and consistently repeat a specific set of asks addressed to identified state and business actors in and beyond China.
- Narrow reliance on ILO forced labour norms and standards may cause legal complications, both because: 1) China is only newly party to the relevant Conventions, and 2) countries agreed over 20 years ago not to enforce these standards through unilateral trade measures such as import bans.
- In addition to the relevant ILO Conventions on forced labour, this set of asks should therefore also encompass China's obligations under:
  - the 1926 Slavery Convention (including its commitments not to enslave people, and to end compulsory labour);
  - the 2000 UN Protocol on Trafficking in Persons; and
  - ILO Conventions Nos 111 (Discrimination (Employment and Occupation) and 122 (Employment Policy), as recently set out by the ILO Committee of Experts on the Application of Conventions and Recommendations (CEACR).
- It should also frame asks of business in terms of the UN Guiding Principles on Business and Human Rights.

Recommendation 2: Create a win-win narrative around sustainable development and fair trade

- In the past, efforts to tackle state-backed forced labour have proven most effective when they have combined sanctions with positive incentives for policy reform, and framed that as a win-win for both the sanctioning coalition and the target state.
- A win-win narrative could help overcome Chinese perceptions of Western positions on Xinjiang as a rear-guard action by hegemonic powers to stave off a rising rival.
- The sanctioning coalition should frame reform of policies on Xinjiang as a way for China to secure the sustainable development of the region, while avoiding the past mistakes of the West in relying on coerced labour for economic development.
- Growing evidence shows that reliance on forced labour impedes sustainable development through 10 channels ranging from reduced productivity and inter-generational poverty to increased risks of political instability and armed conflict (see especially *Developing Freedom*).
- Both the sanctioning coalition and China have an interest in addressing unfairness in the international trading system. Forced labour risks undermining support for free trade because it allows some producers to unfairly reduce the price of their goods, outcompeting foreign rivals. At the same time, unilateral import and export controls designed to protect markets from such unfair competition risk feeding a larger disenchantment with international trade.
- China has sent important (if subtle) signals that it is willing to address forced labour concerns through international trade dispute mechanisms.
- Efforts in sanctioning states to promote national self-sufficiency in the face of Chinese reliance on forced labour face some domestic resistance, given long-standing Western commitment to a liberal trading order.
- The sanctioning coalition should develop a win-win narrative that frames reform of China's Xinjiang policies in terms of securing sustainable development and fair trade. This should be backed up by offers of support to China for such reforms, including technical assistance, expertise, diplomatic engagement and support, and international public and private financing.

Recommendation 3: Sanction entities, not just goods

- Most of the sanctions in place allow firms to continue operating in sanctioning coalition markets, even if they use Xinjiang forced labour.
- The import bans in place in the US and Canada work to prevent firms importing goods made with Xinjiang forced labour, but do not prevent those same firms otherwise operating in the US or Canada if they send Xinjiang forced labour goods to other markets.
- Western consumers may end up paying a premium for 'slavery-free' goods that is used to cross-subsidize production of slave-made goods for other markets.
- This is already beginning to happen in the solar sector and may be happening in other sectors. Mid-supply-chain module and wafer manufacturers are using existing know-how, business relationships and access to capital to develop new 'slavery-free' production capacity, without giving up use of Xinjiang forced labour for other products.

- Policy makers can avoid this outcome by adjusting sanctions, including import bans, to prevent entities that use Xinjiang forced labour from operating in their markets. This requires supplementing a focus on forced labour goods with a greater focus on forced labour entities.

Recommendation 4: Select targets on vulnerability and influence, not market dominance

- Xinjiang sanction targets have emerged organically, including through the action of legislators, customs authorities and investigations by media, academics and civil society.
- While this has led to targeting of a small number of individuals responsible for implementing XPCC and XUAR policies producing forced labour, it has arguably not led to the targeting of architects of these schemes.
- Many of those targeted and otherwise affected are firms. The vulnerability of these firms to sanctions, and their influence over policy makers, does not appear to have been a major factor in target selection or enforcement strategy.
- Some sectors that have been targeted may be sectors in which market structure works against sanctions effectiveness, because Western importers are more vulnerable to the costs imposed by sanctions than are Xinjiang producers and exporters. Solar is an example.
- Going forward, targets for sanctions and enforcement should also consider vulnerability and policy influence.
- This may mean targeting not only firms with ties to the XPCC but also SOEs and other firms with influence in Beijing, such as Ruyi Group, COFCO Tunhe and firms from Zhejiang.
- Different countries in the sanctioning coalition may need to focus on different targets, given different sources of leverage in their economic relationships with China. For example, European markets may have leverage in chili pepper and tomato markets, Japan over walnuts.

Recommendation 5: Use capital market leverage

- Xinjiang is not highly export-dependent, with only around 10 per cent of GDP coming from exports. It is however investment dependent.
- Beijing has poured over USD 310 billion into Xinjiang between 2014 and 2019, not including private investment. XPCC bond issuance rose from 3.4 billion yuan in 2018 to 50.3 billion yuan in 2021.
- Sanctions theory indicates that sanctions are more likely to work if targeted at scarce factors of production. In this case that would mean reducing returns to capital.
- Beijing sets policies to attract capital by increasing returns to capital – for example through corporate income tax reductions, waivers on import tariffs, and preferential access to land. This has succeeded in recent years in attracting major investments by Western companies including Dow Chemical, Tesla and Volkswagen.
- In most cases, nothing prevents Western firms investing in Xinjiang business outside a narrow set of dual-use, military and technology companies. 90 per cent of FDI into Xinjiang in recent years has gone to the mining sector, which is largely untouched by Xinjiang sanctions. Western investment advisors continue to sell Xinjiang as a source of competitive returns, particularly its technology and renewables sectors.
- Major institutional investors such as Vanguard, State Street, Blackrock, UBS and JPMorgan Chase hold investments in firms that have been reported to have connections to Xinjiang forced labour.
- So, too, do some Western policy makers, which may suggest they have perverse incentives when it comes to Xinjiang sanctions. Biden Administration climate envoy John Kerry was reported in late 2021 to have investments in LONGi, a solar firm whose products were detained by US CBP on suspicion of being made with Xinjiang forced labour, as well as YUTU Technology, which is listed on the US Entity List since 2019 due to connections to Xinjiang repression.
- Beijing has also courted Wall Street. Senior figures such as John Thornton, co-chair of the China-US Financial Roundtable, have engaged in discussions on Xinjiang with senior CCP figures.
- The sanctioning coalition could expand existing restrictions on investment in companies with ties to Xinjiang forced labour to sectors that are highly dependent on capital investment, such as fossil fuels, chemicals and energy.
- Policy makers should also consider how to use platform leverage, such as securities disclosure rules and ESG regulation to address forced labour concerns.
- In time, capital markets may also have a role to play in promoting the win-win narrative suggested in Recommendation 2, for example through sustainability-linked financing initiatives.

Recommendation 6: Expand the sanctioning coalition

- Sanctions are more likely to succeed if backed by a large number of states with significant leverage. At present the Xinjiang sanctions coalition is quite small.
- Xinjiang sanctions will have little overall effect if China can simply reallocate trade of Xinjiang forced labour goods to other markets.
- China is actively expanding free trade ties between Xinjiang and countries in Central Asia, South Asia, and South East Asia.
- The sanctioning coalition should counter this by encouraging countries whose producers and exporters stand to lose from Chinese social dumping of Xinjiang forced labour goods.
- This includes cotton producers in Central Asia, tomato producers and processors in West Africa and Latin America, and polysilicon producers in South Korea.

Recommendation 7: Strengthen import ban foundations and enforcement

- The sanctioning coalition should develop a common position on the legal justification for import bans.
- Canada has relied on GATT Article XX(e) (prison labour). While this may apply to forced labour in the VSETC scheme, it is not clear if it would cover forced labour through the Poverty Alleviation through Labour Transfers programme.
- Other options include GATT Articles XX(a) (public morals), XX(b) (human life and health) and XXI(b)(iii) (emergency in international relations).
- Different justifications may create different requirements for how these bans are adopted. In some cases, sanctioning countries may need to consult in specific ways with affected parties (e.g. importing firms) before the ban is imposed.

- Effective enforcement will be critical to sanctions success. It will depend on resourcing, and on smart resource allocation.
- Sanctions enforcing authorities may need to supplement use of documentary evidence with forensic technologies (such as DNA, genotype or isotopic analysis), as well as use of big data and artificial intelligence tools.

Recommendation 8: Reduce the costs of sanctions compliance

- Debates over Xinjiang sanctions downplay the costs of compliance beyond the costs for importers. These costs in fact include increased prices for consumers, loss of market-share in China for Western firms operating there, and risks to personnel.
- No government has policies in place to support firms incurring these costs, or to address consumer price increases. These gaps risk eroding confidence in and support for these policies, if left unaddressed.
- Governments can mitigate these costs through improved access to information. This could help firms, especially SMEs, to undertake due diligence, for example through sharing of information about supply-chains, or publishing information on firms connected to Xinjiang forced labour.
- Governments can also blunt the impacts of counter-measures by providing Western firms export credit or trade facilitation support to help them grow business in new markets to offset lost market share in China as a result of Xinjiang sanctions compliance.
- Another option is to work with online platforms to blunt and prevent harassment and online boycotting in response to Xinjiang sanctions compliance.
- Finally, governments will need to reduce the costs to business of accessing alternative, slavery-free supply as they lose access to Xinjiang suppliers. This will require industrial policy to foster investment and create a policy environment conducive to rapid emergence of alternative supply, [for example in the solar sector](#).

Recommendation 9: Provide and enable remedy options

- To date Xinjiang sanctions have done little to provide or enable remedy for victims of forced labour.
- Some states appear to think it is not possible to provide remedy for state-sponsored forced labour. The recent US government UFLPA Strategy suggests that "[c]orrective action in such cases may be limited to terminating the relationship with the supplier".
- The European Parliament has however called for the new EU forced labour instrument to require companies "responsible" for forced labour to "provide remediation to affected workers prior to import restrictions being lifted".
- Emerging best practice suggests that the adequacy of remediation should be determined in consultation with relevant stakeholders, such as victim and community representatives and international trade unions.
- The sanctioning coalition could use sanctions violation fines and confiscated assets to compensate victims of forced labour as well as support data and evidence-gathering for future accountability processes.

Recommendation 10: Strengthen strategic coordination

- There has been limited coordination within the sanctioning coalition to date. While there has been coordination around a handful of sanctions targets, the timing of sanctions rounds and adoption of guidance to business, there is much more that could be done.
- The sanctioning coalition could strengthen information-sharing, especially as information increases through enforcement of new import bans.
- Coordination on the legal justification for these bans (see Recommendations 1, 7) on the overall narrative framing Xinjiang sanctions (see Recommendation 2) and on guidance to business would also strengthen the consistency of messaging and effectiveness of sanctions.
- There is also scope for closer coordination between public procurement, export credit and development finance institutions around due diligence and remedy in the context of Xinjiang forced labour.
- The sanctioning coalition should develop a mutual recognition system where inclusion of an entity on a shared Entity List triggers sanctions across all participating jurisdictions.
- It could also develop a shared approach to remedy, for example by creating a pooled compensation fund (see Recommendation 9).
- Finally, the sanctioning coalition should develop coordinated industrial policy for accelerated growth of slavery-free supplies of specific goods, such a polysilicon, where importers and buyers will suffer significant costs due to lost Xinjiang supply.

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[i] James Cockayne, *Making Xinjiang Sanctions Work: Addressing forced labour through coercive trade and finance measures* (Nottingham: University of Nottingham, 2022).

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