

The coronavirus pandemic and the governance of global value chains: emerging evidence

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Key messages

- Global value chains (GVCs) had already begun to shorten after the Global Financial Crisis; the coronavirus outbreak may intensify this process, affecting the trade and development trajectories of some suppliers.
- Relaxing competition policy to support purchases and maintain supply by UK retailers should be accompanied by policy measures to support developing country producers; many face drastic reductions in orders and prices, which will prompt bankruptcies and induce new firm-level reorganisation.
- Lead firms have a duty of care towards their employees and the countries in which they operate; UK-led GVCs should stand by their employees across the value chain, in line with other social commitments.
- Development partners can do more to support links in the GVC; some lead firms are already supporting diversification efforts related to COVID-19; trade-related adjustment support should be provided.

COVID-19 and the governance of GVCs

Unlike the 2008/09 Global Financial Crisis, which preceded the Great Recession, COVID-19 is both a Keynesian demand shock and a supply shock. In addition to the transmission of a collapse in demand, supply shocks will occur because economic activity itself must stop to contain the spread of COVID-19. There is no historical parallel to this in modern times.

Comparative developing country [case studies](#) during the GFC showed how value chain governance – between firms and as influenced by governments – mediated vulnerability to the exogenous trade shock and its transmission. The effects will depend on the fiscal and monetary policies of governments and private sector/consumer behaviour within the country as well as across and between countries.

Understanding these systems and their interaction is crucial to effective risk management. This is why the relationships between buyers and suppliers within global value chains (GVCs) matter.

For many developing countries, the ability to effectively respond will be hindered by their relatively weak footing in 2020, in terms of [external reserves](#), compared with, say, prior to the GFC and during the early years of the Millennium Development Goals era (around 2005). The economic shock induced by COVID-19 is likely to be more severe; this will have major implications for the advancement of the 2030 Agenda and the [Sustainable Development Goals \(SDGs\)](#).

What we know now...

- On average, in every country, the top 15% of firms account for most trade; most international trade is within a GVC.
- GVC firms typically import before exporting (intermediate goods trade).
- Services and value chains are deeply integrated.
- Firm-level organisation and relationships matter in the transmission of shocks (internal value governance).
- Management of GVC trade matters for transmission (external trade governance).
- Private sector codes of conduct and best practice are important.

What we don't know...

- How different tiers of suppliers, subcontractors and casual labourers will be affected;
- How long the COVID-19 crisis will last and what the potential second-round effects will be;
- What productive capacity will be available to diversify (e.g. to switch into products/services in response to COVID-19);
- What corporate policies will support or affect producers and workers;
- The ability of response measures (monetary and fiscal) to effectively support investment and sustain employment

The demand shock

The epicentre of the COVID-19 outbreak is moving across the three major hubs of the global economy – Asia, Europe and the US – and the [top trading partners of developing countries](#). Countries in these regions account for [more than half of all global economic activity](#). At least [\\$1–2 trillion](#) has been knocked off the value of the global economy. Major economies will enter into [recession](#), reducing global growth rates. Business activity across the Eurozone collapsed in March to an extent far exceeding that seen even at the height of the GFC, according to PMI surveys across the Eurozone – equivalent to gross domestic product (GDP) falling at a [quarterly rate of around 2%](#). US GDP could fall by an annualised rate of [6% in the first quarter and by 24–30% in the second quarter of 2020](#).

It is not so unrealistic to assume reductions in consumer demand emanating from three hubs of global activity of between 25% and 50% across selected GVCs over Q1–3/2020, which represents a major trade shock. This doesn't even begin to take account of how demand and supply factors will interact within specific developing country contexts.

GVC case studies

Many industries have struggled to meet pre-GFC levels of trade and investment, as many GVCs have begun to [shorten](#) since 2008/09, subsequent Eurozone crises and a more general global trade slowdown. This shortening is likely to intensify, as some of the economic effects of the COVID-19 crisis will entail permanent losses to business and employees.

On the other end of the value chain, in order to adapt to the shock induced by the crisis and to maintain food security, [competition policy](#) has been relaxed to enable retailers in the UK to work more closely with and alongside their suppliers. The asymmetry between retailers and producers in terms of market power is already high within buyer-driven GVCs. A relaxation of rules regarding sourcing strategies should be accompanied by a tightening-up of employers' duty of care across the GVC.

The GFC of 2008/09 demonstrated how value chain governance mediated the transmission of the demand shock; case studies compared Kenya and Ethiopia with Bangladesh and Cambodia. This policy brief revisits these case studies in view of the COVID-19 shock. Consumer behaviour may change because of COVID-19. For example, more demand for fresh fruit and vegetables and other staples (e.g. Giffen goods) is supporting growth of the broader horticultural sector. However, cut flower producers are suffering major losses now as demand has collapsed.

Kenya: The export-oriented cut flowers industry – part of the broader horticultural sector – accounts for around a quarter of Kenya's total exports and provides vital foreign exchange. Demand here has collapsed.

[Direct sales orders have been cut by 50%, sales on the Dutch auction market are down by 70% and prices have reduced](#). Around 1,000 seasonal workers have had [contracts terminated](#). Overall, around [1 million persons](#) will be adversely affected directly and indirectly by the industry's imminent collapse, which will likely halve in value over the next five to six weeks.

Ethiopia: It is difficult to get specific information on effects in Ethiopia, though it is known that producers tend to specialise in the Dutch auction house sales – where prices have collapsed, with [85% of turnover](#) gone. Although Ethiopian Airlines flights have been cancelled, [no employees](#) have been laid off.

In the textiles and clothing GVC, already in 2020 [sales were bracing for a massive decrease](#) – of [over €30 billion](#), with Nike anticipating a [\\$3.5 billion](#) drop in the fourth quarter. Gap had already [lost \\$100 million](#) just in Asia and Europe, before the outbreak really hit North America, its biggest market.

Bangladesh: Garment factories in Bangladesh have now had orders worth more than [\\$2 billion](#) cancelled by brands and retailers because of the global coronavirus crisis. This amounts to around one month's total export value and is likely to exert major pressure on firms and their almost [4 million employees](#). These adverse developments could also affect Bangladesh's future graduation trajectory from least developed country status scheduled for the coming years.

Cambodia: While Cambodian firms will be adversely affected by the collapse in demand, some of its lead firms are supporting diversification efforts. Fashion [giant H&M](#) says it will ask its supply chain to produce personal protective equipment (PPE) to help medical staff tackle the COVID-19 outbreak and use its global networks to deliver them to hospitals as soon as possible.

Supporting all links in the GVC

- All countries have agreed targets related to SDG 8: Promote Inclusive and Sustainable Economic Growth for All. But lead firms are [abandoning suppliers now](#).
- Firms supplying GVCs need urgent and immediate support, not unlike the measures G7 countries are offering to their lead firms.
- Relaxing competition policy for buyers should be accompanied by policy measures ensuring effective support for producers, mitigating any adverse effects.
- Ramp up diversification efforts, including those related to averting the coronavirus crisis; support should be provided to trade-related adjustment.

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